

# **Exporting the Alaska Model: Adapting the Permanent Fund Dividend for Reform around the World**

Edited by

Karl Widerquist and Michael W. Howard

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## OTHER BOOKS BY THE EDITORS

### **Karl Widerquist**

*Alaska's Permanent Fund Dividend: Examining Its Suitability as a Model*, coeditor with Michael W. Howard (Palgrave Macmillan, 2012)

*Basic Income: An Anthology of Contemporary Research*, coeditor with Yannick Vanderborght, Jose Noguera, and Jurgen De Wispelaere (Wiley-Blackwell, forthcoming)

*The Ethics and Economics of the Basic Income Guarantee*, coeditor with Michael Anthony Lewis and Steven Pressman (Ashgate, 2005)

*Economics for Social Workers: The Application of Economic Theory to Social Policy and the Human Services*, with Michael Anthony Lewis (Columbia University Press, 2002)

### **Michael W. Howard**

*Alaska's Permanent Fund Dividend: Examining Its Suitability as a Model*, coeditor with Karl Widerquist (Palgrave Macmillan, 2012)

*Self-Management and the Crisis of Socialism* (Rowman & Littlefield, 2000)

*Socialism* (Humanity Books, 2001)



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## FOREWORD

The genesis of this book, and its paired work published earlier this year, about the Alaska Permanent Fund dividend must start with the British-born American pamphleteer Thomas Paine's *Agrarian Justice* in 1797. In this essay, directed to the French Legislature, Paine beseeched them to consider that they had left out one of the crucial "rights of man," namely, the right to a share of the earth for every person. Paine stated, "There are two kinds of property. Firstly, natural property, or that which comes to us from the Creator of the universe—such as the earth, air, water. Secondly, artificial or acquired property—the invention of men." In the latter, he said "equality is impossible; for to distribute it equally it would be necessary that all should have contributed in the same proportion, which can never be the case; and this being the case, every individual would hold on to his own property, as his right share. Equality of natural property is the subject of this little essay. Every individual in the world is born therein with legitimate claims on a certain kind of property (natural property), or its equivalent."

In this statement, Paine summarized and anticipated the essential problem with basic income advocacy up to the present time. A major source of resistance to the idea of a universal basic income comes from the widespread belief that it is unfair to confiscate a person's own rightfully acquired property and redistribute it to other people who have done nothing to earn it. People tolerate taxation for social purposes to varying degrees, but giving an unconditional dividend check or cash to "undeserving freeloaders" just goes against the grain in most societies, particular in those with a Protestant work ethic. In my opinion, this is the primary reason for the failure of basic income efforts up to now.

On the other hand, if everyone receives a share of "natural property," as Paine suggested, then resistance to basic income will evaporate. Oil companies cannot claim to have put the oil in the ground, and therefore it is widely understood, even in libertarian Alaska, that they don't own it, the people do. Therefore, the collection of rent in

the form of royalties and severance taxes on the extraction of oil and distributing a share to everyone in the state are not seen as a violation of property rights. On the contrary, thanks to Jay Hammond and others, most citizens of Alaska believe the oil belongs to them, and that they are entitled to a share of the rent. I believe this book can help to promote this concept globally.

The difficulty lies in the obfuscation of property rights by oil companies and the governments influenced by them. Oil companies invest money in surveying, exploring, testing, drilling, pumping, storing, piping, and so on, for which they are entitled to be compensated. When they acquire ownership of oil leases, they are able to claim the value of the oil in the ground as well. Even in Alaska, oil companies have been receiving two-thirds of the oil revenues, and the Alaska government receives only one-third. Furthermore, most governments who collect oil rent and create sovereign wealth funds like the one in Alaska do not distribute income from the fund to their citizens. In fact, only Alaska does so, a curious fact investigated by Angela Cummine in chapter 3 of this volume.

Paine lived in an agrarian society, before the widespread exploitation of fossil fuels, where the vast majority of people were farmers, and he proposed in his plan that “Every proprietor, therefore, of cultivated lands, owes to the community a *ground-rent* (for I know of no better term to express the idea) for the land which he holds; and it is from this ground-rent that the fund proposed in this plan is to issue.” The term “ground rent” has been expanded by Ricardo and others to the concept of “economic rent,” referring to the excess income beyond the cost of production. Clearly, there is economic rent from many natural resources, in addition to surface land. This principle can thus be extended to other property not created by individuals, namely, assets created by society in addition to property created by nature. That principle will be expanded in this volume. Although Henry George later popularized Paine’s idea of collecting “ground rent” in the form of land value taxation, George never emphasized direct distribution of revenues as Paine did.

In 1996 I attended the meeting of The Basic Income European (now Earth) Network (BIEN) in Vienna, which had as its theme the two-hundredth anniversary of “Agrarian Justice” by Thomas Paine. Only three presentations in the entire conference dealt with the concept of distributing rent from natural resources; and, inexplicably, Paine was largely left out of the conversation. Europe has a history of supporting social welfare from income taxes and other taxes on production, has a higher level of social solidarity than the United States,

and it seemed to me that most of the members of BIEN at that time did not think that the source of funds for a basic income was very important. Therefore BIEN has not put much emphasis on whether the source of a basic income should be from “acquired (private) property” or from “natural property.”

When Michael Lewis, Karl Widerquist, and several others formed the US Basic Income Guarantee Network in 2000, a number of advocates of the “Paine” approach to basic income began to participate in conferences and promote “economic rent” as the best source of a basic income guarantee. These people include Jeff Smith, Alanna Hartzok, Steven Shafarman, Nic Tideman, myself, and others. Unlike the many members of BIEN in 1996, Karl listened. Although I don’t believe he is philosophically opposed to other approaches, I think Karl became convinced that, from a practical and strategic standpoint, Paine’s approach to basic income has the highest probability of success. Therefore he and Michael Howard were willing to invest enormous time and effort to bring two volumes about resource dividends to print. Karl and Michael have put a tremendous amount of time into these volumes and have done a huge amount of editing, which was particularly valuable to me. I am grateful for their efforts and also commend the many other contributing authors for their work. I hope the reader will also find that “Exporting the Alaska Model” is the best approach to basic income and most likely to contribute to the reduction of poverty and misery, which has not abated since the days of Thomas Paine.

GARY FLOMENHOFT



## PREFACE

I suppose you could trace the origins of this work back hundreds of years, but most directly you could trace the origin of this book to our realization last year that we had too much material on our assessment of Alaska's Permanent Fund Dividend (PFD) to fit in a single book.

In hindsight, this realization should not have been surprising. The PFD has existed for 30 years with great success and popularity. Yet, as far as we know, there are no major scholarly books in economics, politics, or philosophy examining the fund and dividend or considering the combination as a model for imitation. Because we tried to assess the dividend from the angles of economics, politics, or philosophy, and both internally and as a model for export, it is not surprising we couldn't accomplish our task in one book. Therefore, in the summer of 2011, we got permission from the publisher to divide our project in two.

The first book, *Alaska's Permanent Fund Dividend: Examining Its Suitability as a Model*, focuses on evaluating the PFD and its funding source, the Alaska Permanent Fund (APF), as they stand. It examines the history of the APF and the PFD and their social and economic consequences. It includes assessments of the PFD as a resource dividend and as basic income from the standpoint of left-libertarianism, liberal egalitarianism, civic republicanism, and practical politics. Although the Alaska model can be given a strong left-libertarian justification, as concisely expressed in Gary Flomenhoft's Foreword, we think it can be defended from rival ethical perspectives as well, such as liberal egalitarianism and civic republicanism. Liberal egalitarians welcome citizen dividends as a policy contributing to a fairer distribution of wealth and income and as a measure that can reduce poverty or expand opportunity.<sup>1</sup> Civic republicans welcome citizen dividends to the extent that they can insure the independence and equal standing of citizens.<sup>2</sup> Both can support dividends funded through resource taxation, but are not as committed to reliance on resource taxation or tax shifting as some left-libertarians,<sup>3</sup> and both are open to dividends, as well as government expenditures, funded through income

or wealth taxes.<sup>4</sup> The first book came out in February 2012. We believe it establishes the usefulness of the combination of the APF and PFD as a model and draws useful lessons from it.

This second book discusses how the Alaska model will need to be adapted to be used in other places and times (including in a future Alaska with a very different economy). It has given us the opportunity to examine the economies of far-flung nations around the globe, and we greatly appreciate the contributions of all the authors who made this book happen.

KARL WIDERQUIST AND MICHAEL W. HOWARD

#### NOTES

1. See essays by Zelleke (2012), and Howard and Widerquist (2012d), in Widerquist and Howard 2012a, and Griffin in this volume.
2. See Casassus and DeWispelaere (2012) in Widerquist and Howard 2012a.
3. See Hartzok, Flomenhoft, in this volume.
4. See Widerquist chapters 13 and 18 on Citizens' Capital Accounts, and Howard chapter 10 on carbon dividends, in this volume.

## ACKNOWLEDGMENTS

Many of the chapters of this book were presented, discussed, and developed either at the Tenth Annual North American Basic Income Guarantee Congress, in conjunction with the Eastern Economic Association Meeting in New York City, during February 25–27, 2011, or at the Conference on “Exporting the Alaska Model,” held at the Institute for Social and Economic Research at the University of Alaska, Anchorage, on April 22, 2011.

We would like to thank Scott Goldsmith for organizing and handling most of the logistics of the conference at the University of Alaska, Anchorage, and Cliff Groh and Gregg Erickson for their assistance with the program. We would also like to thank all of our contacts at the Eastern Economics Association for helping us to hold the North American Basic Income Guarantee Congress.

We thank all the authors who contributed to this book and to the previous book (*Alaska’s Permanent Fund Dividend: Examining Its Suitability as a Model*, Palgrave Macmillan 2012) and who participated in the events mentioned above. We would also like to thank all the other participants at both these events for a lively and informative exchange of ideas. They include, but are certainly not limited to, Terrence Cole, Rick Halford, and Fran Ulmer. Thanks also to Charles Wohlforth, who was unable to attend the Anchorage conference but gave us many valuable ideas and put us in contact with several of the people who contributed to the book and the conference.

We would also like to thank Laurie Harting from Palgrave Macmillan for approaching us at an earlier Basic Income Guarantee Congress and asking us to put a book together; we thank our new editor at Palgrave Macmillan, Samantha Hasey, and her assistant Leila Campoli. Everyone else at Palgrave also deserves thanks for helping get this book out.

Karl thanks his wife Elizabeth, his parents, and his siblings. He would like to thank Georgetown University, Qatar, for its support and resources. Michael thanks his wife Valerie and his daughter Emma for their support and encouragement, and the University of Maine for its support and resources, including a sabbatical leave in Spring 2011.



## Introduction



Exporting an Idea

*Karl Widerquist and Michael W. Howard*

Our earlier book, *Alaska's Permanent Fund Dividend: Examining Its Suitability as a Model*, examined the Alaska Permanent Fund (APF) and the accompanying Permanent Fund Dividend (PFD) from economic, political, and ethical perspectives. It concluded that although the two programs are not perfectly designed, they are a unique and innovative combination from which we can learn and on which we can improve. The two programs together constitute a model that we can adapt for use elsewhere. This book examines how the “Alaska model” can be adapted for use in other places, times, and circumstances.

The first section of this introductory chapter summarizes our definition of the Alaska model. Section two reviews the lessons our earlier work outlined from observations of the Alaska model and the need to adapt that model and build on it. Section three then previews the book.

1. WHAT IS THE ALASKA MODEL?

The “Alaska model,” as we use the term here, does not refer to the whole of Alaskan state government policy (most of which we do not study and cannot evaluate), or even to the whole of its oil revenue policy. It refers only to elements in the combination of APF and PFD. Although the APF is the source of revenue for the PFD, the two are different programs created at different times by different kinds of legislation. The APF is a Sovereign Wealth Fund (SWF)—a pool of assets collectively owned by the members of a political community and usually invested in interest-generating investments. It was

established by a constitutional amendment that did not specify what was to be done with the returns to the fund. The PFD is the policy of devoting the APF's returns to a dividend for all Alaskan citizen residents. It was created by a simple act of the state legislature. Many nations and regions have SWFs, but only Alaska's SWF pays a regular dividend to its citizens. Many nations and regions provide some form of cash benefits, but only a few pay regular dividends to citizens, and, so far, only Alaska has been paying a regular cash dividend linked to a permanent resource-based endowment. The APF-PFD combination links a resource-revenue-management policy with a progressive social policy. As an SWF, the APF helps to ensure that the state will continue to benefit from its oil even after its reserves are depleted. As a dividend, the PFD helps every single Alaskan make ends meet each year without a bureaucracy to judge him or her and ensures that all Alaskans receive some tangible benefit from the state's oil wealth.

In our earlier book (Widerquist and Howard 2012), we dubbed this unique combination the Alaska model. It consists of three elements: (1) resource-based revenue, (2) which is put into an SWF or some other permanent endowment, (3) the returns of which are distributed as a cash payment to all citizens or all residents. The extent to which a policy has to contain all three of these elements to qualify as following the Alaska model is difficult to determine, but we believe each element is important, and so it is worthwhile to reiterate the importance of each of these three elements.

### *A. Resource Revenue*

The ethical case for taxing natural resources is at least as good as, and probably better than, the case for taxing any other source of wealth. In fact, it is questionable whether resource taxes should be considered taxes at all. Many political philosophers argue that the natural resources of a nation ultimately belong to the people of that nation.<sup>1</sup> Any "tax" on such resources can be fairly described, and justified, as an appropriate user fee. We're so used to governments giving away natural resources to corporations who sell them back to the people that fees for such resources seem like any other tax; but when one realizes that privatization of the gifts of nature places distinct and sometimes onerous duties on others, the ethical justification for a user fee on private use of natural resources becomes obvious. One simple reason to move toward common-asset-based government financing can be gained from common experience. If you are like most people, you have paid both rent and income taxes. Which is easier? Of course, it is

much easier to pay a regular rent than to navigate (or hire an accountant to navigate) the complexities of the income tax or corporate tax code. It would be easier for individuals and also for businesses simply to pay rents on all the resources they use, and it would be progressive because wealthier people and businesses use more resources.

Resource taxes also have practical benefits. They can be used to discourage overuse of scarce resources. If properly employed, they can be an important part of a green environmental management strategy giving people the incentive to reduce their consumption of scarce resources to sustainable levels. Of course, not every country has as much oil as Alaska, but as this book will show, every nation of the world has enormously valuable common resources, most of which are given away for free to a few who sell them back to the many. We argued in our earlier book that shifting taxes to resources makes sense both from a practical and from an ethical standpoint. This book will argue that a great deal of money—perhaps enough to fund an entire government and pay a dividend as well—can be derived from common resource taxation (see chapter 6 by Flomenhoft in this volume and our concluding chapter).<sup>2</sup>

### ***B. A Permanent Endowment***

Alaska is not the only place in the world where the government receives most of its revenue from resources. For example, oil-rich Persian Gulf countries, such as Qatar and Saudi Arabia, raise all of their government revenue from user fees on natural resource extraction. No taxes are necessary. But this situation is temporary. Alaska's oil is a finite resource. It will run out eventually, as will all the resource revenues in the Gulf. The APF was set up as Alaska's attempt to transform its temporary resource windfall into a permanent endowment, but it is a small attempt. Less than one-fifth of the state's resource revenue has gone into the fund.

An SWF is not the only mechanism that can create a permanent resource-based endowment. Many common assets are capable of producing a permanent stream of revenue from user fees without the need to go into a fund. These include land, the broadcast spectrum, all renewable resources, and common social assets such as money creation. A fund is necessary only to turn a temporary stream of resource revenue into a permanent income. For other assets, all that a government needs to do is to treat them the way most nations treat oil fields—as the people's property rented out for private use to the highest bidder. Therefore, the Alaska model, as we conceive it, requires a

permanent fund only if and when the resource revenue stream is likely to be temporary. Otherwise, direct distribution of revenue can be consistent with the goal of creating a permanent endowment.

### *C. A Cash Payment to All Citizens*

The justification for resource taxation discussed above connects very closely with the dividend. People who own natural resources make them unavailable for others to use either collectively or privately. Owners should pay for that burden in cash. If everyone pays for the resources they own and receives compensation for the resources they do not own, we will all both pay and receive, but, on average, people who use more will pay more than they receive, and people who use less will receive more than they pay. People who own resources privately often create opportunities for others, but they are not duty bound to make sure they actually do it, and resources often are spent on lavish luxuries that create few, if any, opportunities for others. Also, because resource owners pay no one (other than the previous private owner of those resources) for the privilege of holding natural resources privately, they can capture both the value they add to the resource *and* the scarcity value of the resource itself. Thus, the poorest of the poor in our international market economy are actually less healthy and poorer than our distant ancestors who foraged on unowned land. A resource-based cash dividend simply means the end of something-for-nothing. You can own a piece of the commons, as long as you compensate others for what you make unavailable to them.

There are many practical reasons for a dividend as well. It is an efficient and effective solution to poverty, involving little or no cumbersome government bureaucracy.<sup>3</sup> Jay Hammond saw it as a way to use collective greed as a check on private greed.<sup>4</sup> Resource revenue—or any kind of government revenue—attracts political corruption. Powerful individuals want a piece of that revenue. They have a powerful incentive to find some excuse to get legislators to spend, lend, or donate some of that money to them. Legislators often find such pressure impossible to resist, and policies that directly benefit a few can be easily dressed up as an investment in helping the many. As Hammond saw it, by predetermining that some or all revenue goes directly to the people, we can ensure that at least some resource revenue benefits all people. We can also give the people as a whole an incentive to pay close attention to what the government does with its endowment.<sup>5</sup> An unconditional, regular cash payment to all citizens is often called a “basic income guarantee.” This idea figures significantly in

the discussions in this book, and therefore a brief introduction to it is worthwhile. Any policy that unconditionally ensures every citizen a nonzero income is a basic income guarantee. A “full” basic income guarantee ensures an income large enough to meet a person’s basic needs—enough to keep a person out of poverty. A smaller unconditional income is usually called a “partial” basic income guarantee.

Several different kinds of policies can ensure some kind of basic income guarantee. The two most commonly discussed policies are the “negative income tax” and the “basic income.” The negative income tax ensures that no one’s income falls below a certain amount by distributing targeted benefits to people with low incomes. Basic income instead gives a small income to everyone regardless of their income from other sources. The negative income tax is a program clearly aimed at addressing poverty. The basic income also might be motivated by a concern for poverty; the universality of a basic income ensures that it gets to everyone who needs it and avoids stigmatizing one part of the population. But it might be motivated by other concerns as well, such as the desire to ensure that everyone, rich or poor, benefits from the extraction of oil whether or not they have a direct connection to it.

The negative income tax was widely discussed by economists, politicians, and welfare activists in the 1960s and 1970s. Based on Jay Hammond’s remarks at the 2004 US Basic Income Guarantee Network conference, we believe that Jay Hammond was influenced by this discussion. It has recently appeared on the political agenda in Germany. A basic income pilot project is under way in Namibia. The policy has considerable grassroots support in southern Africa today, and the Brazilian government is officially committed to phasing it in, although no timetable for moving beyond the first stage of the phase-in has been set. The concept of basic income is currently popular with the Green parties and left-leaning parties in Europe, but its support (much like the support of the Alaska Dividend) often cuts across party and left-right divides.<sup>6</sup> The Indian government will soon begin a basic income pilot project similar to the North American negative income tax experiments.<sup>7</sup> And Iran has a form of basic income already under way, although it is still being phased-in to its full size.<sup>8</sup>

Nothing about basic income or the basic income guarantee ties it to any specific type of financing. There have been proposals to support it by income taxes, sales taxes, money creation, and almost any conceivable form of government revenue. The Alaska model finances basic income directly from a financial endowment and indirectly

from user fees on oil extraction. Therefore, it is, in effect, a resource-financed basic income.

As discussed in our earlier book, not everyone agrees about the extent to which the Alaska Dividend fits the definition of a basic income. Usually, a full basic income is defined as an unconditional income large and regular enough to meet a person's basic needs. The Alaska Dividend is neither regular in size nor large enough to meet a person's basic needs. But it is regular in timing and is unconditional. So, it constitutes only a partial, irregular basic income, but it is the only version of basic income currently in practice in the industrialized world.

## 2. LESSONS FROM THE ALASKA MODEL

In the concluding chapter of our earlier book, we drew six lessons from our observations of the Alaska model. Because this book is about how to adapt the Alaska model to best employ the lessons learned from it elsewhere, it is worthwhile reviewing those lessons.

First, resource dividends are popular and they work. As our earlier book argues, the PFD is one of the most popular state government policies in Alaska and possibly one of the most popular in any state in the United States. It provides a badly needed supplement to the incomes of all Alaskans, including the homeless, with no conditions other than proof of residency. At a time when progressive economic policies have been under attack across the United States and much of the industrialized world, the PFD has become "the third rail of Alaskan politics," meaning that any politician who touches it dies. Alaska has one of the lowest poverty rates in the United States, and it is the only US state that has become more economically equal over the past two or three decades. These developments are at least partially attributable to the PFD, and its existence has coincided with robust economic growth and a good climate for industry.

Second, a state or nation does not have to be resource-rich to have a resource dividend. We argue thus because Alaska isn't unusually rich; because the state has used only a small fraction of its resource wealth to fund the APF and PFD; and because every nation, state, and region has enormously valuable common resources. Often the difference between a "resource-rich" and a "resource-poor" state is that the resource-rich state has a large amount of the types of common resources that governments generally tax while the resource-poor state has a large amount of the types of common resources that governments typically give away for free. Flomenhoft (chapter 6, this



volume) backs up this casual observation with empirical evidence. He finds that the resource-poor state of Vermont could support a resource dividend at least as large as, and possibly much larger than, Alaska's current dividend if it made judicious use of its resource base.

Third, good policies are put in place when people and politicians look for opportunities. If the reason Alaskans have the dividend is not that they are resource-rich, what is the reason they have it? They have it because the right people were in the right places at the right time, and they took advantage of the political opportunities to create the APF and PFD. It's tempting—but wrong—to think of Alaska's experience as some aberration. Common resources are being privatized all the time all over the planet. Every new well that's drilled is an opportunity to assert community control of resources. So is every new mine that's dug, and every new reserve that's discovered. Michael Howard discusses one such opportunity in his chapter (chapter 10) on the possible link between carbon taxes and a carbon dividend.

Fourth, the people need to see themselves as the owners of the commons, not only as owners but also as monopolists. One might fear that a resource dividend will make people more willing to accept the private depletion of resources. Once the people make some money selling resources to private industry, they might think they can make more money by selling more resources. But before we assume that this possibility is a foregone conclusion, we should remember that industry has done a great deal of damage to the environment for centuries without paying any dividend. The assertion of the power to demand a payment in exchange for the use of a resource is the assertion of ownership over that resource. And along with ownership comes the power to set the terms. Those terms can be powerful environmental controls. If the acceptance of those terms is what industry must do to buy access to common resources, it will have to accept those terms.

Once we assert community ownership over common resources, we must recognize that the community has *monopoly* ownership over its resources. Monopolists do not maximize profit by selling all they can at the lowest price. They make money by holding back the supply of their commodity so that it will command a higher price. If thought of in this way, a dividend can be a powerful part of a government strategy. We can have more parks, bigger nature reserves, cleaner air, and safer water while we make more and more money selling resources to private industry. Fifth, a successful policy builds a constituency. Policies that help only a few people in a major way or help many people in a barely noticeable way are constantly in political danger. Policies that help

many people in a major way might be harder to create initially, but they're politically safer in the long run. Social Security and Medicare are two of the largest progressive social policies ever created in the United States. They were difficult to initiate, yet they have survived attacks against the US social welfare system over the past 30 years while so many small programs have been cut back or eliminated. These social policies survive partly because they are so large. So many voters benefit from them that it is difficult for politicians to cut them. The universality of the PFD takes that strategy one step further. Every single Alaska resident benefits from it. Suppose a politician wants to take money out of the PFD to put into program X. To be worth the sacrifice of the PFD to any individual Alaskan, program X would have to produce a sure benefit that was better than \$1,500 per year, every year, for as long as that Alaskan expects to live in Alaska. Very few proposals can pass that test. The PFD is protected by its own significance. To replicate the success of the PFD elsewhere requires a program of similar universality and size.

Sixth, successful policies also avoid creating an opposition. This lesson is essentially the converse of the fifth lesson. From lesson five we see that a policy is politically safer if the constituency on which it confers a benefit is larger and the benefits to them are more significant. We should, therefore, also recognize that a policy is safer the fewer people it harms, the less significant those harms are to them, and the more politically difficult it is to oppose those harms. Policies designed to get group A to help group B are particularly vulnerable to this problem. Group A will always be there as an opposition to such a policy. Policies such as the minimum wage and rent control put most of the burden on one specific easily identifiable group, who will probably fight the program as long as it exists. Programs financed by progressive income taxes can create an opposition if people connect the burden of paying taxes with programs they see themselves as unlikely to need. Recognizing this divide, US politicians have been able to demonize "welfare mothers" and create a large constituency in favor of cutting social programs to finance top-rate income tax deductions.

The PFD is financed directly by the APF. The APF is just a pool of assets. No group of voters sees those assets as being theirs through any other means than the PFD. It has no natural opposition among voters (perhaps its opposition is only among politicians who would like to have the power to use that money to help their friends and harm their enemies). Of course, the APF is created and continually enlarged by taxes (or "royalties") on oil drilling. But the oil companies

aren't complaining. It was part of the deal they made to obtain the right to drill. Complaining about that now would be like complaining that they have to pay a price for steel, trucks, or ships. It doesn't make sense to complain about what is obviously an unavoidable cost of doing business. The state owns the oil fields. Anyone who wants to drill must pay. The same can be true of all resources. People know that they have to pay to obtain ownership of resources. They are used to paying the previous generation of owners. Under a resource-tax system, people pay less to previous owners and more in user fees, but they pay, either way. That's just the way of the world. There's no use opposing it.

We can see from these lessons that the Alaska model is a powerful idea that could be employed on a much larger scale in many more places. How we can adapt the model for use on different scales in different times and different places is the subject of this book.

### 3. A PREVIEW OF THIS BOOK

This book is divided into three parts. Part I discusses employing the Alaska model in circumstances similar to those of Alaska: in wealthy, resource-exporting nations and regions. Part II discusses applications of the model further afield. And Part III discusses a hybrid proposal for an individualized version of Alaska's fund and dividend.

Hamid Tabatabai (chapter 2) begins Part I with a discussion of the second place in the world to introduce a resource dividend: of all places, Iran. Like Alaska, Iran stumbled upon the dividend following a peculiar set of circumstances. For most of its period as a resource-exporting nation, Iran has used its resource wealth to support an inefficient system of commodity subsidies (mostly on gas and oil consumption). Iranian politicians knew that these subsidies had to go, but the policies benefited so many people in such a significant way that the politicians knew they could not eliminate them without a similarly broad-based policy (discussed as the fifth lesson in section 2 above). After lengthy discussions, the policy that emerged was a basic income in the form of a regular resource dividend. The policy is not funded by a permanent resource endowment, but it does employ the other two elements of the Alaska model.

Angela Cummine (chapter 3) looks at the very opposite issue. There are many SWFs in the world today. Some of them are many times larger than the APF. Yet, only the APF pays a dividend. Given the enormous popularity of the PFD, why have no other resource-exporting nations imitated it? Employing information gained from

interviews and other sources, Cummine assesses the reasons SWF managers around the world are skeptical about dividends.

Alanna Hartzok (chapter 4) looks back at the Alaska model itself in advance of export. She argues that the APF and PFD embody the idea of socializing the rent of assets that rightfully belong to the people as a whole, but to do this, managers at the Alaska Permanent Fund Corporation (APFC) should take on a strong responsibility toward social investing, and they are not yet living up to that responsibility. Any nation or region wishing to socialize rent on a large or small scale should, therefore, take a look at what the APFC has done right and what it has done wrong.

Rather than looking at employing the Alaska model in other places, Cliff Groh (chapter 5) looks at the future of the Alaska model in Alaska. Although the PFD has a sound permanent endowment in the APF, it is the only part of the Alaska government that has such safe financial footing. Most of Alaska's state budget is based on current oil export revenues. The volume of Alaskan oil exports has been declining for more than 20 years. So far, increases in the price of oil have more than made up for the decline in the volume of oil exports, but they will not always do so. When oil revenue begins to dry up, there will be enormous pressure on the state government budget, which will also put pressure on the APF and PFD. Groh discusses when this might happen, what it will mean, and what can be done about it.

Gary Flomenhoft begins Part II with a chapter (chapter 6) estimating the potential for a common-asset-based dividend in the "resource-poor" state of Vermont. He shows that even Vermont has many resources that are being given away for free by government to corporations who sell those resources back to the people at higher prices. Flomenhoft estimates how much revenue the state could generate by treating those assets the way Alaska treats its oil. In his low estimate, he finds that Vermont could support a dividend at least as large as Alaska's; and in his high estimate, he finds that Vermont could support a dividend many times larger—perhaps more than \$10,000 a year for every Vermonter. If a resource-poor state such as Vermont can do it, any state or nation can too.

Paul Segal (chapter 7) discusses employing the Alaska model in the poorer nations of the world and discusses the impact on poverty of doing so. He finds that a resource dividend could cut world poverty by more than half, as measured by the World Bank's poverty rate of US\$1.25 per day at purchasing-power-parity.

Jason Hickel (chapter 8) examines the potential impact of the Alaska model on a less developed nation—the newly independent

state of South Sudan. Although South Sudan has large oil reserves to draw on, the potential impact of the Alaska model on it is hard to estimate because the state is so new and few good data are available. However, he finds that oil exports have the potential to finance both a substantial dividend and significant infrastructure improvements.

Jay Hammond's contribution (chapter 9) applies the Alaska model to Iraq. Hammond was the fourth governor of the state of Alaska and is justly described as the father of the PFD. He campaigned for the idea long after he left office. His posthumous contribution to this book is a piece he wrote near the end of his life suggesting that a permanent fund and dividend would help ensure that Iraq's oil revenues were shared by members of all of its diverse communities. This chapter includes a brief introduction by Larry Smith.

Michael W. Howard's chapter (chapter 10) discusses the cap-and-dividend approach to global warming as a politically viable way of applying the Alaska model at the federal level in the United States. The idea of cap-and-dividend is simple. The government limits the amount of carbon emissions allowed (the cap). It sells the rights to make those emissions to the highest bidder and redistributes the proceeds as a dividend for all citizens.

Widerquist closes Part II with two chapters (chapters 11 and 12). The first examines the possibility for, and potential size of, a permanent common-asset-based endowment for the United States. The second examines the prospects of exporting the Alaska model back home to Alaska to widen and deepen the use of the strategy we call the Alaska model in Alaska itself. Widerquist argues that a fuller use of the Alaska model will strengthen Alaska against the likely eventual decline in resource revenues.

Part III of the book is entirely devoted to the discussion of a proposal by Karl Widerquist to create an individualized version of the permanent fund and dividend approach. Widerquist's proposal, called Citizens' Capital Accounts (CCAs) (chapter 13), assigns a portion of the principal of the fund to each individual at birth. They can decide when and whether to draw dividends, but the principal must remain in the fund for future generations. Widerquist argues that CCAs provide more economic security for the money than basic income or other similar proposals, because they allow individuals to keep the returns in their safe investment account until they are needed. Subsequent chapters by Michael W. Howard, Jason Berntsen, Ayelet Banai, and Christopher L. Griffin, Jr. (chapters 14–17) evaluate, criticize, and consider variations of the CCA proposal. In the final chapter of part III (chapter 18), Widerquist responds to criticism.

In the book's final chapter (chapter 19), we review some of the findings of this book and consider the menu of options available for a government to employ variations of the Alaska model.

#### NOTES

1. Carter 2012; Vallentyne and Steiner 2000a and 2000b; see also chapters by Hartzok and Flomenhoft in this volume.
2. The point is that the natural resources are available in abundance, and tax shifting should be given serious consideration. It may, nevertheless, be desirable to maintain a mix of resource and income taxation—as even Governor Jay Hammond (1996), the father of the PFD, argued when he opposed the abolition of the income tax in Alaska.
3. Vallentyne and Steiner 2000a and 2000b.
4. Hammond 1996.
5. Hammond 1996.
6. US Basic Income Guarantee Network 2011; Basic Income Earth Network 2011; Basic Income Earth Network and affiliates 2011.
7. Shrinivasan 2011.
8. See Tabatabai, this volume.

## PART I

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Expansion of the Model Using  
Existing Funds and Dividends





## CHAPTER 2

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### From Price Subsidies to Basic Income: The Iran Model and Its Lessons

*Hamid Tabatabai*

#### INTRODUCTION

In December 2010, Iran launched a five-year program to reform its system of price subsidies. In the first of several stages, subsidies were partially cut by raising prices of fuel products and some other goods and services, in most cases, several-fold. The net proceeds were partly earmarked to finance a compensatory cash transfer program that pays every Iranian residing in the country the equivalent of \$40–45 a month, unconditionally. The later stages of the reform will see further rises in prices and transfer payments in tandem until subsidies are entirely eliminated. This, in a nutshell, is the “Iran model” of basic income. It differs in some respects from the common conceptions of basic income in the literature and may therefore be more accurately termed a “de facto basic income.” The story of how this de facto basic income came into being and some of its early results are recounted elsewhere.<sup>1</sup> This chapter focuses on the model itself, elaborating on its key features, its genesis, the challenges it faces, and some of its lessons.

#### THE KEY FEATURES OF THE IRAN MODEL

The Alaska model of basic income has been in place for about three decades. It has by now matured to a point that this book and its companion volume are devoted to helping export the model to the rest of the United States and to other countries.

An alternative model of basic income has recently emerged in Iran that, while sharing some features of the Alaska model, contrasts with it in other respects. Both models rest on oil as the natural resource whose rent is partially distributed to the entire population in cash on a regular basis, and free from all conditionalities. In each case, all those eligible—residents in the case of Alaska, citizens in the case of Iran—are entitled to the same transfer amount regardless of individual characteristics (age, income, etc.) and for an indefinite period. But the Iran model possesses some distinctive features that make it particularly noteworthy and instructive. Among these are the following:

1. *Scope and scale*: Iran's de facto basic income is by far the largest and most "generous" program of its kind in the world; indeed, it is unique in its national scope. Its initial transfer amount of roughly US\$500 a year per capita is, as a proportion of average national income, several times higher than the annual dividend in Alaska, and the population covered is over a hundred times larger. It reaches some 72.5 million people, or 96 percent of Iran's population of 75.3 million (the remaining 4 percent have voluntarily forfeited their entitlement). Furthermore, when the reform process has run its full course, cash transfers to households will be of the order of 15 percent of national income, far above Alaska's average of 3–4 percent.<sup>2</sup>
2. *Emergence by default*: The basic income of Iran emerged largely by default. The universality of cash payments became the operating principle simply because the identification of the initially targeted population—the seven deciles of the population with incomes below the national average—failed for both technical reasons and inadequate public support. The universality of coverage, in turn, led to the uniformity of transfer amount for all.
3. *Piggybacking on a larger issue*: Iran's basic income was not a policy objective in its own right. Rather, it turned out to be the most convenient way of compensating the population for the withdrawal of inordinately high price subsidies that the reform effort aimed to eliminate. It played an instrumental role by facilitating the implementation of a policy agenda to address a larger issue of national concern.
4. *Payment to household heads*: The entitlements of members of a household are paid out not to them individually but to the head of the household on their behalf. This is because, the transfers being a form of compensation for subsidy cuts, they should go

to the person who is responsible for paying the higher bills, which is normally the head of the household.

5. *Novel method of financing*: The transfer program is financed through higher prices for subsidized goods and services, primarily fuel products, whose (mostly implicit) subsidies are being phased out. It puts no burden on existing revenue sources such as the national budget or oil exports. This method of financing a basic income has not often been considered in the basic income literature.
6. *Unlikely venue*: Finally, Iran's basic income emerged in a developing, Middle Eastern, Islamic country, contrary to the widespread expectations that a basic income would only be affordable and likely to arise first in more developed countries, particularly of the European variety.

Such distinctive features have in various ways contributed to making basic income a reality in Iran. That is where their main significance lies. But these features are not necessarily as effective in ensuring its continuation. On the contrary, some of these features have the potential to jeopardize the sustainability of the program over the longer term. The "generosity" of the transfer amount, for example, may turn into a threat to the universality of coverage. The instrumental role of basic income may at some point become immaterial, thereby undermining its *raison d'être*, an outcome that would be less likely if basic income were grounded in a more solid foundation as a right of citizenship and an end in itself. The program in Iran is in its infancy and there is a good deal of trial and error and learning by doing, with no guarantee of survival in its current shape or form. It is indeed facing challenges that make its future somewhat uncertain. We shall discuss these challenges below, but to appreciate them better we need first to consider the genesis of the program.

#### THE GENESIS OF THE IRAN MODEL

Iran is a major producer and exporter of oil. The oil sector is nationalized, and the entire proceeds from exports and domestic sales go to the government. For decades Iranians have benefited from this natural wealth in two main ways: (1) public expenditures (current and capital) by the government, and (2) implicit subsidies on fuel products whose domestic prices were kept extremely low. Low fuel prices bred a culture of excessive consumption, inefficient production, waste, pollution, smuggling to neighboring countries, as well as inequality

as the bulk of the subsidies went to the better-off sections of the population who consumed more. By official estimates, the subsidy bill in recent years has been of the order of \$100–120 billion annually, of which 70 percent went to only 30 percent of the population, mostly in urban areas.<sup>3</sup>

The reform of price subsidies has accordingly been a long-standing policy concern. Successive governments tried to address the problem but failed to make much progress in the face of political and public resistance. In June 2008, however, the government of President Mahmoud Ahmadinejad took a radically different approach by unveiling a plan to phase out price subsidies over several years, replacing them with “cash subsidies” to households and businesses alike. The reform would also extend to electricity and water services, transport, bread, and some other items too, but over 90 percent of the subsidies concerned fuel products. The subsidy reform was designed to improve resource allocation, with more rational relative prices and a larger scope for market forces, on the one hand, and to promote social justice by redistributing the oil rent in favor of lower income people, on the other.<sup>4</sup>

The government’s initial intent was to limit the transfers to the less well-off sections of the population, namely, the seven lower deciles with incomes below the national average. To determine eligibility for the transfer, households were required to fill out a Household Economic Information Form providing information on the composition of their households, incomes and assets, participation in state assistance programs, and so on. The identification of beneficiaries used a model that estimated household income on the basis of various proxy indicators (habitable area per person, car ownership, level of education, family loans, etc.) on which data had been collected. The estimated income was used for the classification if it was more than the self-reported income; otherwise the reported income was used. The results, however, led to a great deal of discontent as many households were unhappy about their exclusion and protested. Rather than alienating a part of the population, the government eventually decided to abandon the exercise and declared everyone eligible for transfers, at least initially. The universal basic income was thus born as a means of ensuring wider public support for the price reform.

Universal coverage then heralded the uniformity of transfer amount for all. Although the amount could in principle vary by such easily ascertainable criteria as age or region of residence—higher amounts for the more deprived provinces was one of the options considered—in the end the simplest option of uniform payment was adopted. As

regards the transfer amount, no official figure was available until the reform was launched, but speculation was rife, with most estimates hovering around \$10–25 per person per month, depending on the underlying assumptions.

After over 18 months of discussion and debate, a modified version of the government plan was approved by the parliament, and the Subsidy Reform Law was enacted in January 2010.<sup>5</sup> The law sets aside up to 50 percent of net proceeds from higher prices for direct payment to households in cash. That amount could eventually reach some \$50–60 billion a year or about 15 percent of national income. The other half, another \$50–60 billion a year, would be used to assist industry and agriculture in their adjustment to the loss of subsidies, to improve infrastructure, and to strengthen the country's social security system. These are massive sums with potentially profound implications for the economy at macro and micro levels. But they place no new burden on the national budget or revenues from oil exports. The transfers are financed by households, businesses, and the government through the higher prices they pay for the goods and services that would no longer be subsidized. The reform implied a massive redistribution of household incomes, one that could be designed to favor the lower-income strata at the expense of those who had hitherto benefited the most from the outgoing price subsidies.

Contrary to government wishes, the law imposed a period of five years, instead of three, for the implementation process. Additionally, it limited the net proceeds from higher prices in the first year to \$10–20 billion. These provisions were aimed at ensuring a more gradual pace of reform and moderating inflationary pressures from subsidy cuts. The latter provision, in particular, had been vehemently opposed by the government as it implied a maximum monthly transfer of about \$17 per person, or 5 percent of the minimum wage, which would have little incentive effect and jeopardized public support. Having failed to get its way, the government seized upon loopholes in the law and delayed launching the reform for nine months beyond the start date of March 2010 envisaged in the law. This delay made it possible both to accelerate the pace of reform and to set the transfer amount at a much higher level, since the government then went on to generate a good part of the authorized revenues for the first year in only its final quarter. This implied enormous increases in prices of subsidized goods, which varied from 75 percent to 2000 percent depending on the item and, in some cases, on the quantity purchased, region of the country, and season. The price shock was regarded by the government as desirable, since more drastic changes in relative prices would have

more of an impact on the behavior of consumers and producers more rapidly. But the main reason was to allow the transfer amount to be set at a much higher level than it would have been possible otherwise, since the “inflated” revenues collected over three months would also be distributed over three months. The transfer amount was thus set at 455,000 *rials* or \$40–45<sup>6</sup> per person per month, nearly three times the maximum amount consistent with strict adherence to the provisions of the law, which is about \$17. In effect, the government was obeying the letter of the law that imposed a \$10–20 billion range for revenues in the first year while running roughshod over its gradualist spirit by the massive price rises it decreed to generate the authorized amount in only three months. In fact, over the period of an entire year, the price adjustments would yield closer to \$40–60 billion, depending on how consumption got affected. Just about half of the subsidies were thus cut in one fell swoop, instead of gradually over two to three years.

Cash transfers to households started at the same time that price increases went into effect on December 19, 2010. At this time, only about 80 percent of the households had completed the formalities required to qualify for the transfer, which involved filling out the registration form and supplying a bank account into which the payment would be deposited. Of the 20 percent of households that did not participate, about half had not applied at all, most likely because they did not wish to report their incomes and assets, were not impressed with the transfer amount likely to be involved—which was not known at registration time before the launch of the reform—or were simply unaware of the program. The other half had filled out the registration form but chose to suspend their participation by withholding bank account details. This gesture followed government appeals to those who were better-off to forego their entitlement voluntarily so as to leave more funds for those who needed the transfer. These appeals followed the decision to make payments universal, which put pressure on available resources.

But the situation evolved once the cash started to flow. In the first few months of the program the number of participants rose from 60 million to 72.5 million, or from 80 percent of the population to 96 percent.<sup>7</sup> The most significant factor accounting for the precipitous rise in participation was likely the amount of the transfer that, as discussed before, turned out to be much higher than anticipated, just as price rises were. The government, furthermore, promised that the amount would remain unchanged until at least March 2012, after which it would be adjusted upward in line with further price increases

in later stages of the reform process. Staying out of the program voluntarily had thus become financially more costly. There were other contributing factors as well. First, with targeting abandoned, the information on incomes and assets was no longer relevant to eligibility, and the concern about its scrutiny by the government may well have eased or disappeared altogether.<sup>8</sup> Second, the bureaucratic registration process was simplified, giving way to registration through the Internet. Third, with the transfer program already operational, the more skeptical people who were biding their time during the long uncertain period before the program was launched may have been encouraged to put in their claims once the situation cleared up. And fourth, the sense of solidarity that motivated some people to stay away may have evolved with the realization that charitable purposes could be served just as well or better privately by the beneficiaries themselves rather than through the government.

But while payments to households have been regular over the course of the first year of the program, those destined for businesses and the public sector have been anything but regular, and for good reason. Once household payments are made, there is rather little left for businesses and the government.<sup>9</sup> The universality of payments, their relatively high level, and, to make matters worse, the apparent overestimation of expected revenues seem to have thrown the finances of the program into disarray, with far-reaching consequences, as we shall see below. To some extent the program appears to have become a victim of its own success or that of the reform more generally. On the one hand, given the extremely large increases in prices, the shortfall in revenues might be due in part to the unexpectedly large decline in the consumption of goods and services concerned, which was of the order of 20–30 percent in many cases.<sup>10</sup> On the other hand, the sharp rise in participation in the early months of the program was no doubt a reflection of its growing popularity, given the attractiveness of the transfer amount.

#### POTENTIAL LESSONS FROM THE IRAN MODEL

The basic income experience in Iran is in its infancy and it is too early to draw definitive conclusions and lessons from it. Nonetheless, its very birth and novelty raise issues that bear on the approach to the promotion of basic income and its prospects under different circumstances. This section discusses some of these issues with a view to drawing tentative lessons that might contribute to making basic income more of a realistic proposition in different contexts.

## *Advocacy for Basic Income*

Guy Standing has identified three main lines of thinking that have dominated the basic income conversation over the past quarter century: (1) one that is broadly philosophical and libertarian, stressing the appeal of a basic income as a right and as a stand-alone matter; (2) another that sees basic income as one component of a redistributive political and economic strategy; and (3) a third line that is becoming increasingly important, namely, the potential of a basic income as a means of enhancing a more gendered and ecologically viable future.<sup>11</sup> In the case of Iran, it is the second that has been the dominant influence. The first and third lines of thinking played little or no part, although the ecological factor did figure in since the main subsidized commodities are fuel products. The rights-based arguments would have been a nonstarter. The adoption of the subsidy reform and the birth of a *de facto* basic income owe much to the fact that cash transfers are universally seen as compensation for the loss of subsidies, not as a right or entitlement without a *quid pro quo*. That is how the hurdle of reciprocity was overcome.<sup>12</sup>

However, even the significance of basic income as a component of a redistributive strategy should be seen in context. Iran's version of basic income evolved not by design but by default. It was not a policy objective in itself but the fortuitous outcome of a broader process aimed at correcting an inefficient and inequitable system of subsidies. It served to facilitate the reform by making it more acceptable to politicians and the public at large. In a sense, the country stumbled upon basic income while pursuing a different objective, an objective that was indeed partly motivated by distributional considerations. This unique experience highlights the instrumental potential of basic income in smoothing the way toward better resource allocation and greater equality, the two objectives of Iran's reform. The experience is all the more significant as it takes place in a country largely unaware of the wider discourse on basic income. The concept's very simplicity appears to account for its emergence in the national search for an appealing alternative to an irrational system of subsidies. It just seemed to make sense.

Potential lessons: (i) overemphasis on rights may not always be the best political strategy for promoting basic income; (ii) the compensatory nature of the transfers can help overcome objections rooted in the principle of reciprocity; (iii) piggybacking on a larger issue may open up fruitful opportunities for the promotion of basic income; (iv) one can conceivably stumble on a basic income under certain circumstances.



### *Financing a Basic Income*

A major hurdle facing a basic income program is often finding resources to fund it. In Iran, the problem was turned on its head: the funds were going to be available, but a use for them had to be found. The de facto basic income emerged as a way of using up a large portion of those funds. In this regard the situation is analogous to Alaska's, but the funding source is different. Alaska's model relies on dividends from a fund established from taxes levied on oil producers. Iran's model is financed through higher prices for subsidized goods and services whose (mostly implicit) subsidies are being phased out. This method of financing a basic income is not discussed much in the literature, but it has its merits. One was mentioned before: it puts no new claim on existing sources; for example, on the national budget or oil export revenues. Another is pointed out by Philippe Van Parijs, who contrasts Iran's approach with that of Alaska, noting:

In many places, this is a far more realistic option than an Alaska-type permanent fund program... the Alaska scheme is funded out of the interest collected from investments made worldwide with revenues generated by the production of oil at some point in the past, whereas the Iranian scheme should be understood to be funded out of a tax on the current consumption of oil. The Alaska-type scheme is therefore restricted to resource-rich (sub-) countries that manage at some point to exercise sufficient political self-restraint to create and develop a substantial fund. The Iranian-type scheme, by contrast, is available to any country that wants to price the consumption of oil in an ecologically responsible way and to buffer the effect on people's standard of living in a socially responsible way. For this road to basic income to be a real option there is no need to first accumulate a large fund, nor indeed to be an oil-producing or resource-rich country.<sup>13</sup>

Over the longer term, however, the Alaska model has the advantage of a permanent flow whereas the Iran model does not. There have been contradictory reports as to where policy makers stand on the issue of the duration of the program.<sup>14</sup> Since the subsidies are being cut permanently, one might presume that the compensatory transfers too would continue indefinitely. That is because the resources from higher prices would keep coming in so long as Iran is able to produce enough fuel for its domestic market, fuel that could be sold at subsidized prices as before but would not be. Beyond that point, when Iran will have to import its fuel, there would be no revenues any more unless fuel is taxed. That prospect lies in the distant future, however, since Iran's oil and gas reserves will last for many years still.

Over the shorter term, the main risk to the transfers arises from drastic declines in international oil prices. This would narrow the gap with potentially subsidized domestic prices and reduce revenues from subsidy cuts. In such a case, the government could either bring down domestic fuel prices in line with international prices and lower the transfer amount in tandem, or it could leave domestic prices above international prices and continue with the transfers at the same level as before. The former option would be more in line with the current law, but the latter is more likely in practice, both politically and socially, as it would be less disruptive of the economy.

The more immediate challenge, however, is financing the transfers at present. As noted before, universal payments at a fairly high level (relative to the volume of resources flowing in) is putting considerable pressure on available funds, so much so that up to 80 percent of the proceeds from higher prices are going to households, a proportion that should be closer to 50 percent according to the law. This is not a sustainable situation, and various options are being explored to remedy it. Short of drawing on other sources for supplementary funds, which would in principle be illegal, the burden of adjustment would have to fall on households. That implies cuts in the number of people participating in the program or in the amount of the transfer, a dilemma to which we now turn.

Potential lessons: (i) Iran's model of generating resources for a basic income is potentially applicable in many other countries as well, even those that may not have fuel resources of their own or subsidized fuel; (ii) the Alaska model of dividend payment may have greater long-term sustainability.

### *Universal Coverage and the Transfer Amount*

One of the main justifications for universality lies in the shortcomings of targeting, in particular, type 1 error, that is, excluding some of the intended beneficiaries.<sup>15</sup> But the universality that gets rid of type 1 error compounds type 2 error by including all those who could do without the benefit. In justifying a universal basic income, one often gets around the latter objection by invoking the "right" of everyone to the transfer as a citizen, regardless of their state of well-being. This line of argument is reinforced by arguing that even if the payments to the rich were to be regarded as in some sense undeserved or unjustified, they could in principle be recovered through other means—taxation of income or of luxuries, for example—so as to maintain the principle of universality. The argument is considerably weakened,

however, if the tax system cannot be relied upon to do so. This is the case in Iran, not so much because the taxation system cannot do so, but because resources, other than through higher prices for subsidized goods and services, cannot legally be used for the purpose of cash transfers, at least under the current law.

In this context, the resources available for financing cash transfers may be regarded as exogenously given or “fixed,” in the sense that they depend on the extent of price hikes and the volume of goods and services purchased but not on the program’s coverage or the transfer amount. The distribution of the resources, whatever their volume, is thus subject to a trade-off between the number of beneficiaries and the amount of the transfer to each. The original idea in Iran was to cover 70 percent of the population having incomes below the national average. With the adoption of universality, the transfer amount could only be 70 percent of the amount that would have been possible to pay the originally targeted 70 percent of the population. The universality thus comes at the expense of the lower income groups who could have received more had those with higher incomes been excluded. To avoid this, the government initially drew on other resources to fill the gap, contrary to the stipulations of the law. This approach, however, could not be continued indefinitely; a more durable solution called for a review of the coverage and/or the transfer amount. At the time of writing (December 2011), there is increasing evidence that the principle of universality may soon be sacrificed, with some better-off households being dropped from the program due to resource constraints.<sup>16</sup> It is not clear how these households might be identified or what their numbers might be.

Abandoning universality altogether is one approach to saving resources when they are “fixed.” In view of the drawbacks of targeting, though, it may not be the best remedy. After all, the universality in Iran came about precisely because of the failure of the attempt at targeting cash subsidies, a lesson that should not be lost sight of too readily. Another approach is the one that was in place before the reform program started, namely, voluntary nonparticipation. Universal entitlement does not have to mean that everyone should get the benefit, since some might prefer to opt out on a *voluntary* basis: for whatever reason, as long as those opting out can do just fine without the benefit. Voluntary self-exclusion saves resources and makes universality more acceptable to the general public by quenching the deserving/undeserving tension. It might even be actively encouraged. Indeed, going further, participation may be made “costly” in ways that would not deter the poor but may dissuade the rich, a logic that resembles, for example,

the subsidization of low quality foods that are less attractive to those who can afford to do without them. In Iran, reluctance to provide sensitive information on incomes and assets at the time of registration and the appeal to the sense of solidarity of the better-off seem to have performed that function well initially, although their impact wore off considerably once the program got under way, with a sharp decline from 20 percent to only 4 percent in the proportion of households that continued staying out of the program voluntarily. We have noted some possible reasons for this development, and the specifics of the Iran case are not the main point here. The main point is, rather, that voluntary self-exclusion might be an appropriate approach to addressing the tension between universality and resource requirements. The way it might work or be encouraged may differ from place to place, but it may be an approach worth investigating, particularly in situations where the proportion of the public to be excluded is not large. To come back to the Iran case, it should be noted that by law, the receipt of cash subsidies is subject to households providing accurate information on their socioeconomic status, including on incomes and assets, at registration. If the information proves to be inaccurate, the law calls for legal action to be taken by the government to recover the amounts so paid and discontinue future payments. This provision does not appear to be enforced to any significant extent, if at all. If it were, even selectively, it may induce many well-off households to withdraw voluntarily, or to continue staying away. This is not meant as a recommendation but as an example of possible measures that might relieve the funding constraint without discarding the principle of universality.

In this context, three further observations may be made. The first concerns the impact of inflation on the transfers. Given the relatively high and accelerating rate of inflation—currently hovering around 20 percent, although some believe it to be higher—the purchasing power of the transfers is diminishing rapidly. Over the longer term, the government’s easiest option to reduce the burden of the transfers might be to let inflation erode their real value.

The second observation has to do with the recipients. The cash transfers in Iran go to the head of the household on behalf of all its members. As the payments become more and more well established, the concern about their impact on intra-household welfare becomes increasingly more important, perhaps even more important than their compensatory nature. If it is shown over time that the welfare of the household could be improved through individual payments to its adult members, the current practice may evolve. In the interest of expanding people’s choices, a first step might already be to allow

households to express a preference between payment to a household head or to adults individually (children's share would, of course, go to the parents or guardians).

Finally, the compensatory character of the cash transfers in Iran has allowed a major amplification of the impact of relative price changes on resource allocation and the speed of adjustment as it made it possible for the price reform to go deeper and faster. The scale of price hikes in Iran, which were of the order of several hundred percent, are unprecedented not only in the country itself but virtually anywhere else in the world. Yet the reaction of the population was largely tolerant, if wary. This is mainly because of the grant that helped cushion the shock. In efforts at price reform, therefore, the scale of price adjustments may not be as critical as it is often presumed to be, so long as the adverse effects can be moderated or removed entirely through compensation, particularly for poorer people.

Potential lessons: (i) there is normally a trade-off between universality and transfer amount in the context of a developing country; (ii) universal entitlement need not mean universal payment if the better-off can be induced to forego their entitlement voluntarily; (iii) whether the payments are made at the individual or household level must be adapted to local circumstances; (iv) the public tolerance of price increases depends on compensatory arrangements.

### *Constituency Building*

The subsidy reform in Iran was a government initiative that, far from enjoying public support, aroused deep anxiety throughout the society. It was the most radical economic transformation Iranians were going to experience in living memory. The government called it "economic surgery." The cash transfer component of it was designed in part to alleviate public concern and build support for the reform on the strength of the argument that a large part of the population would, in fact, receive more in cash subsidy than they would lose from cuts in price subsidies. The sensitivity of the government to public reaction was considerable, as exemplified by the adoption of universal coverage when protests mounted against the exclusion of a third of the population from the transfer program. During implementation too, changes have been made to meet public demands, for example, from bimonthly to monthly payments to facilitate management of household budgets.

But the cash transfer program, while popular, does not enjoy universal support. Some experts have called for it to be scrapped, with

the funds redirected to other priorities, for example, job creation or expansion of public services. Others are less categorical and would support a certain portion of the funds being distributed in cash to poorer groups. Universal coverage came about for lack of a practical alternative. It had few advocates per se and may yet prove to be short-lived, even if retreating from it may be harder now since it is already in place. But even if some of the better-off households are excluded from the program, their number is unlikely to be large. The success of the reform depends on the vast majority of the people feeling that they are not being cheated out of their fair share of the oil wealth.

It may be useful here to consider selected results of an opinion poll on the reform carried out by an unidentified official agency.<sup>17</sup> It covers Tehran, the capital city, and was taken soon after the reform was launched. The poll showed that the transfers were about as likely to be spent as saved: 41 percent of respondents had spent it all, 37 percent had saved it all, with the remaining 22 percent having divided it up between consumption and saving. Nonetheless, a majority (62 percent) believed that for most people the transfers would not cover the extra expenses due to higher prices, even if they reduced their consumption. Some 33 percent thought that they could do so. A similar majority (65 percent) felt that the reform would help “correct” the consumption pattern, although others (28 percent) had little confidence that it would. Perhaps most importantly, the respondents were split down the middle between those who had much or very much confidence that the reform program would succeed (40 percent) and those who had little or very little confidence that it would (39 percent). And more people rated the chances of the transfers continuing as little or very little (42 percent) than those who rated these chances as high or very high (36 percent). It should be noted that public opinion in rural and other urban areas that are less privileged than Tehran is likely to be more favorable to the reform, as price subsidies tend to favor the better-off whereas cash subsidies are the same for everyone.

Potential lessons: (i) cash transfers, once in place, can develop a large constituency behind them, for both economic and political reasons; (ii) public support of cash transfers could be strengthened if they also addressed widely acknowledged problems (for example, irrational consumption patterns).

#### CONCLUDING OBSERVATIONS

The replacement of price subsidies by a cash subsidy program of unprecedented scope and scale has placed Iran in the forefront of all

countries in advancing toward a nationwide basic income. The fact that this development has taken place first in a developing, Middle Eastern, Islamic state, rather than in a developed European country, as widely presumed, underlines the relevance of the basic income concept for a broad range of countries. In view of the great diversity across countries, issues concerning the relationship of basic income with the stage of development and cultural differences deserve detailed study, in particular the extent to which arguing for basic income may have to contend with the variety of prevailing conditions and circumstances.

That said, is there anything that is unique about Iran? The specificities of the Iranian experience should not be ignored. It is in large part the combined availability of domestic fuel resources and an exceptionally distorted pricing policy that made it possible, indeed almost inevitable, for a de facto basic income to emerge as part of the solution. But those specificities should not be exaggerated either. There may also be scope in some other countries with large subsidy bills or potential for indirect taxation to explore the feasibility and wisdom of rerouting their resources to fund a basic income. Iran's experience may hold some lessons of wider applicability if they are properly drawn and found to be convincing.

There have been many challenges along the road to a basic income in Iran and more lie ahead. Its future is by no means guaranteed. While its actual existence may have created conditions for the development of a strong constituency to maintain it, the best guarantee for its continuation would be to show convincingly that the larger price subsidy reform, of which it is an integral part, is indeed working reasonably well and could work better still. That calls for systematic and continuing evaluation of the impact of the reform in terms of its own explicitly stated objectives as also in related areas that may be affected. The lessons, positive or negative, will help resolve the outstanding policy issues, improve the functioning of the program, and help make it less vulnerable to shifting political currents.

#### NOTES

1. Tabatabai 2011; and Tabatabai, forthcoming.
2. Calculated based on data in Widerquist and Howard 2012a,
3. It should be noted that subsidies are mostly implicit, not financed by oil exports or the budget. They arise because domestically produced oil and gas are sold cheaply on the local market.
4. For an account in English of his TV address, see Ahmadinejad 2008.
5. For the full text of the Subsidy Reform Law in English, see Guillaume et al. 2011, Appendix I.

6. The Iranian currency, *rial*, is subject to a managed floating exchange rate regime that has effectively kept it pegged to the US dollar for years at rates hovering around US\$1 = RIs10,000, or more recently RIs11,000. All references to dollar are to the US dollar.
7. Farzin 2011.
8. Such information, however, continues to be required of new applicants as part of an effort to build up a socioeconomic profile of the nation.
9. In the first three months of the program, for example, revenues amounted to \$8.6 billion (*Iran Economist* 2011), while \$8.1 billion was paid out to households (\$45 per person per month X 3 months X 60 million participants in early months), far above the household share of 50 percent (maximum 60 percent for the year) authorized under the law.
10. Tabatabai, 2012 (forthcoming).
11. Standing 2011.
12. See Tabatabai 2011.
13. Van Parijs 2010, 3–4.
14. Kaviani 2011.
15. See, for example, Jhabvala and Standing 2010.
16. See, *Donya-e Eqtesad* 2011.
17. *Ayandeh News* 2011. It should be noted that opinion polls in Iran are rare, and the publication of their results rarer still, particularly on sensitive issues. If they are conducted, it is usually to allow the sponsoring institution, often an official body, to gauge the mood of the public on some issue, keeping the results confidential. The results of this poll were leaked to the press, perhaps only partially.



Overcoming Dividend Skepticism:  
Why the World's Sovereign Wealth Funds are Not Paying Dividends

*Angela Cummine*

Over 50 countries around the world possess a Sovereign Wealth Fund (SWF), yet only the Alaska Permanent Fund (APF) directly distributes profits to national citizens. The first volume of this series demonstrated the desirability of resource dividends practically (as a tool of socioeconomic/resource management policy) and philosophically (as a demand of justice), providing the theoretical justification for similar schemes in other resource-rich or SWF-possessing states. Curiously though, Alaska's Permanent Fund Dividend remains an isolated example of SWF dividend distribution. Despite more than two-thirds of the world's sovereign funds being established since the year 2000, none have introduced a dividend scheme, nor is there any appetite within these organisations for such a move. On the contrary, the global sovereign fund community displays a near universal antidividend consensus.

This chapter contributes to the exportability debate regarding the Alaska model by identifying sovereign funds' nondistribution preference and critiquing it in order to bolster the plausibility of SWF-funded dividends.<sup>1</sup> The anti-dividend posture among SWFs constitutes a major obstacle to the successful rollout of the Alaska model elsewhere, at the very time when more governments than ever enjoy new wealth levels through their recently created sovereign funds. By challenging the legitimacy of SWF skepticism towards dividend distribution, the

recent proliferation in sovereign fund establishment would ideally be matched by a similarly rapid increase in their use as a financing source for egalitarian redistribution going forward.

Before we proceed, two caveats are necessary.<sup>2</sup> First, the current antividend posture may be a product of timing rather than of institutional preference. Following the upheavals of the global financial crisis, it is not surprising that cynicism exists regarding dividend desirability. Unexpected disruptions to the strategic asset allocations of funds, forced asset sales at market lows and the disgorging of monies to rescue packages, national budgets, and stimulus programs make for a difficult climate in which to discuss further distribution of sovereign wealth. Second, treating SWFs as an aggregate unit may falsely imply the existence of a coordinated opposition to dividends. This is not the intention. Rather, in full recognition of the diversity in cultural, national, and formation rationale factors behind each fund, this chapter takes as striking the common opposition to dividends among SWFs and seeks to elucidate more precisely the nature of that opposition.

I consider the antividend case by setting out and testing four common objections to dividend schemes advanced by SWFs. These are the *anticonsumption objection*, the *diluted returns objection*, the *savings objection*, and the *technical concerns objection*. Treating each objection on its own, this chapter challenges the persuasiveness of the entrenched antividend posture. Section 2 discusses these objections and reveals that far from a coherent antidistribution philosophy, there is considerable variation in SWF perception of the detrimental effects of dividends. Fundamentally, SWFs are sensitive to the specific fiscal demands of their own host economies and express reluctance to implement cash distributions in light of these demands. This suggests there is room for maneuver where dividends can be made compatible with domestic fiscal demands. Indeed, dividends emerge as far more feasible than the current monolith of opposition implies, boding well for the development of targeted dividend proposals adapted to the needs of individual SWFs. Section 3 concludes by offering some thoughts on the reasons behind the strength of the current antidistribution posture.

## 1. OBJECTIONS TO DIVIDEND DISTRIBUTION

Discussions with SWF representatives reveal a number of practical and philosophical objections to the idea of SWF-funded dividend schemes.<sup>3</sup> For many funds, the issue of dividend distribution

has not been explicitly considered by management or ruled out as a policy option. Yet, when asked about the idea, SWF representatives respond with skepticism. The essence of the response is that dividends are incompatible with the core purpose of an SWF—to ring-fence resource returns as part of a fiscal strategy to manage the macroeconomic effects of resource booms and save for long-term expenditures. Against this understanding, distribution amounts to disgorging and diminishing these assets, jeopardizing the fundamental goal of an SWF. Beyond the presumption of conceptual incompatibility between dividends and the purpose of SWFs, a number of specific concerns were identified. Consequently, an automatic but not necessarily justified preference for nondistribution exists within the SWF community. This institutional skepticism is one of the most powerful obstacles to the rollout of dividend programs. While there are some valid concerns couched within these objections, they are not sufficient to warrant an unequivocal antidistribution preference. The four most common objections are examined below.

### *A. Anticonsumption Objection*

The most frequently advanced objection to dividends is that they they consume national wealth that should ideally be invested. This concern typically surfaces in small population, resource-dependent economies. For such economies, ring-fencing and investment of resource windfalls are crucial because the national source of prosperity is finite. Establishing alternative sources of income is difficult since economic diversification is considered harder in states with comparatively smaller workforces. SWFs help to diversify and preserve transient sources of prosperity by turning temporary resource revenues into permanent financial investments. Examples in the SWF world of high resource-dependence and low diversification economies include Norway, Azerbaijan, and the Gulf states of Kuwait, Oman, the UAE, and Qatar. Despite the relative wealth of these countries, none support regular dividend policies since expenditure on dividends is viewed as consumption of resource revenues that should be preserved and augmented through investment.<sup>4</sup>

While such a view represents prudence regarding management of finite resource windfalls, its underlying economic rationale is flawed. The crucial problem with this objection is its characterization of dividend payments as consumption. In economics, consumption is typically defined as the purchase of final goods. Technically speaking then, consumption of dividend payments does not occur until citizens use

this capital to purchase a good or a service. Recipients may, however, choose to spend their dividend on intermediate goods or financial assets. In this case, the dividend is invested, not consumed. On this view, the only difference between dividend-distribution and pooling of resources in an SWF is that under a dividend scheme the ultimate investment or consumption decision is transferred to household or individual units rather than retained by government. Dividends do not by definition amount to consumption. They simply transfer the investment-consumption decision out of government hands into those of individuals who may consume or invest.

Even so, one could still argue that dividend schemes are a far riskier proposition for preserving revenues if individuals are more likely to consume than invest their dividend. This brings us to the second anticonsumption reply. Evidence suggests that we cannot assume individuals will automatically consume their dividend. Empirical data from Alaska indicates that dividend use is mixed. In a poll conducted by a local Alaskan news station following receipt of the 2009 PFD, respondents were asked what they would do with their dividend that year. Of the 857 surveyed, 24 percent said “Spend,” 33 percent said “Save,” and 40 percent said “A little of both.”<sup>5</sup> This echoes the results of an informal survey conducted by the Alaska Permanent Fund Corporation (APFC) 15 years earlier on the use of dividend checks, in which three-quarters of respondents reported that they planned to save half or more of the dividend (including debt reduction).<sup>6</sup> A decade prior to that, in 1984, there was also strong anecdotal evidence of dividend saving. Approximately one-third of dividend income went to saving and debt reduction, after federal income tax.

Academic research on how receipt of the PFD affects Alaskans’ consumption behavior also found no evidence of a sudden spike in consumption behavior by Alaskan households following PFD payment that would support a presumption of “dividend blowing.”<sup>7</sup> The author of a 2003 report into this subject found “no evidence that the seasonal pattern of consumption in Alaska differs from that in the other 49 states or that households in Alaska are subject to fewer liquidity constraints, engage in less buffer-stock saving, or spend a smaller fraction of their income on semi-durable goods than households in the rest of the United States.” One interpretation of this data is that Alaskans either save their dividend income or use it to pay down debt.<sup>8</sup> While other interpretations are possible, this research casts doubt over the assumption that individuals are automatic dividend spenders. It does not, however, disprove the thesis that over time too much of the dividend goes into consumption spending.

For this reason, such findings must be treated carefully. Goldsmith has argued that even if we can rely on survey data regarding what Alaskans will do with their checks, this only indicates what individuals did with the payment immediately upon receipt, not how their consumption behavior may have changed over time.<sup>9</sup> Furthermore, Goldsmith has argued that if people view the dividend payment as indefinite, then they may spread consumption over a lifetime, treating it like a permanent increase in annual income.<sup>10</sup> Known to economists as the “Permanent Income Hypothesis,” this theory would distinguish between “proximate” and “ultimate” use of dividend funds.<sup>11</sup> Absence of a consumption spike at the time of PFD payment might not indicate savings, but may simply indicate smoothed consumption over a lifecycle. In Alaska, this is circumstantially supported by the fact that there is no evidence of dividends having led to “a significant accumulation of wealth or provided a base of assets, or ‘grubstake’ . . . leading to private sector investments generating economic development,”<sup>12</sup> but, equally, there is no significant evidence supporting massive increases in consumption.

Even where there is some evidence of increased expenditure around the time of the PFD, this cannot be taken as proof of *dividend* consumption, since those funds may be used to purchase goods that Alaskans were likely to purchase irrespective of whether they received the PFD. The coincidental timing of their expenditure with dividend receipt may thus be better explained as resulting from a perception of increased liquidity rather than “dividend blowing.” In other words, the PFD may be influencing *timing* of preplanned consumption, not increasing overall consumption. If we draw again on the results of the 1984 survey of dividend use, despite most respondents indicating that the dividend went on daily expenses, most said it had little or no effect on consumption behavior. That is, it didn’t increase overall consumption. To illustrate, Goldsmith often refers to the fact that on certain dividend use surveys many Alaskans indicate they would use their PFD money to purchase winter clothes for their children, hardly an item they would have forgone in the absence of a dividend.<sup>13</sup>

In short, then, the evidence of dividend consumption versus saving is mixed in Alaska. The mix of evidence suggests the PFD does not encourage consumption sprees. At best, it may alter the timing of consumption, but one may still choose to privilege the more rigorous study that finds no evidence of a consumption spike. Unfortunately, rigorous longitudinal data of dividend use do not yet exist. For decisive conclusions about dividend behavior, we need to collate data on how Alaskan citizens’ savings fluctuate proportionally in relation to

the PFD payment. If the dividend causes people's income to go up by X percent, we need evidence that individual savings are increasing by more than X percent to establish that more of the dividend is being saved than of individuals' regular income. In the interim, we can speculate based on the combination of anecdotal use surveys and quantitative analyses that there are reasonable grounds for questioning the assumption that individuals are more likely to be automatic consumers.

Even if individuals do consume their dividends, the converse assumption that, because resource revenues are quarantined in government coffers and collectively invested, they are consumption immune is equally misguided. For a start, certain funds mandate spending of their sovereign wealth according to structured expenditure rules. Norway, for instance, has a fiscal spending rule that requires 4 percent of real returns of its Government Petroleum Fund Global (GPF) to be paid into the state budget annually to finance the non-oil deficit. It could be argued that since this macroeconomically responsible amount is already 100 percent committed to consumption of investment through the budget cycle, there is no good reason why this amount could not alternatively be allocated directly to individuals who may consume or invest the capital. If, on top of this, you accept arguments regarding the collective wisdom of agents being, on average, in the longer term more accurate than a centrally planned government approach, then the assumption that dividend distribution to individuals automatically equals consumption is misguided.

Equally significant is the observation that SWF-held resources are at risk of a more severe type of consumption since the fate of collectively held funds is dependent on market performance. Market volatility poses a risk of both capital consumption and, more worryingly, capital *destruction*. The potential losses from market exposure for large institutional investors were evident during the 2008 financial crisis. Again turning to Norway, in 2008 the GPF experienced sharp declines, posting a negative return of 23.3 percent.<sup>14</sup> While the GPF has recovered over the past few years, the performance of the fund as at 2008 involved capital destruction.<sup>15</sup> The high fees of fund managers also exacerbate capital consumption, collapsing further the strict binary between dividends as consumption and SWF management as investment.<sup>16</sup> Clearly, individuals could "blow" their dividend capital on gambling, hedonism or high risk investment in volatile markets. The difference is that every single individual would have to simultaneously decide to blow or risk their dividend in this manner to amount to the sort of magnified market risk sovereign

funds face as a concentrated pool of assets seeking returns solely from the markets. Even if diversified across different asset classes and invested through different fund managers, these funds remain financial assets and are restricted to return-seeking in specific types of markets that bring with them peculiar risk profiles. Dividends in the hands of individuals will not have the same opportunity for leveraging and return-seeking as when in financial manager hands, but at the same time, they will also not experience the same concentrated risk and may be invested and consumed in a far more diverse manner than if limited to being held as financial assets competing with other institutional investors.

In these ways, a more high-risk notion of consumption attaches to SWF investment than individual consumption.

### ***B. Diluted Returns Objection***

A second objection to dividends is that they would result in diluted returns on resource wealth. The idea here is that the larger the capital sum to be invested, the higher the potential return. A finance analogy brings out the point. In finance speak, the term “Diluted Earnings Per Share” is a performance metric used to measure what a company’s earnings per share would be if all convertible securities were exercised. Convertible securities are securities that may convert into stock such as stock options, convertible preferred shares or warrants, and therefore exist as additional potential shares in a company. If these extra shares are created in a company and earnings remain the same, the earnings per share decrease.

Similarly, when the resource wealth of a nation sits within an SWF, it effectively has a single shareholder—the government. While the government represents millions of individual shareholders that comprise its citizen body, its legal shareholder is the aggregate entity of government. The earnings per share are therefore very high as returns attach to just one share, the holder of which represents the ultimate owners of a nation’s resource wealth. Since paying dividends can be justified on the basis that it is monetizing individual ownership of national resources, giving each citizen his or her own direct share of sovereign wealth is analogous to converting potential company shares into actual shares and in the process diluting returns or the earnings per share of sovereign wealth.

A simple arithmetic example illustrates this: the Australian SWF, the Future Fund, currently holds close to AUD\$70 billion. If this were divided up on a per capita basis among the 22 million residents

of Australia, it would amount to approximately \$3,200 per person. However, as members of the Australian community, each citizen has a stake in the \$70 billion fund. Each citizen jointly holds this one stock worth \$70 billion, as opposed to each individual holding a one 22 millionth of this stock worth \$3,200. Moreover, even if individuals took their per capita share and generated similar percentage returns on their individual pots of stock, this is a much less efficient way to generate returns. Also, the same universe of investment opportunity is not available to individuals as it is to institutional investors. In addition to enriching individuals within a community, this shared economic asset enriches the Australian community itself, since this capital will ultimately be used to meet long-term expenditures for the nation. Dividing up the collective pool of resource wealth on a per capita basis within nations thus significantly dilutes returns at both the collective and individual level.

What can be said in reply? Two simple points: first, the analogy does not hold since a dividend program does not represent the act of creating new shares. Rather, it merely indicates the pro rata value of each individual's share of the existing capital pool; or, more precisely, based on the typical meaning of dividend in finance, the pro rata value of each individual's share of annual *net profits*. By either definition, the point is that dividends do not create *new* shares in this wealth. Moreover, in practical terms, this approach of giving every individual a per capita "chunk" of an SWF's *total* holdings would be an unusual model for dividend distribution. As we know, the Alaska model only distributes real returns, preserving principal resource revenues for reinvestment. That said, however, the approach discussed has been mooted elsewhere. Following its 2003 discovery of copper and gold deposits, Mongolia recently announced that it would set up a USD\$30 billion SWF and would consider distributing USD\$6 billion in dividends to Mongolian citizens.<sup>17</sup> One model under consideration involved a universal, flat, onetime payout to every citizen of Mongolia as a matter of birthright.<sup>18</sup>

Second, dividend programs do not preclude the benefits of pooled investment since distribution would take place after returns are sought at fund level. At the stage of return seeking, there is still only one shareholder for whom returns are sought, so the benefits of large institutional investing are preserved. In Alaska's case, dividends are distributed on an annual basis *after* returns are made on the fund balance and are calculated using the average of the fund's income over five years in order to produce a more stable flow of dividend amounts.<sup>19</sup> On the APF model, the main disadvantage from an



investment perspective is that the total amount of investment-producing capital available for reinvestment each year is reduced by the cost of the previous year's dividend. The only way the principal can grow is through increased resource revenues from the market (larger volume of sales and/or higher oil prices). Although the principal is never touched to pay dividends, the income-producing capital is capped by the cost of the PFD. Contrast this with other SWFs whose principal capital is augmented each year by both their resource activity revenues *and* the return on the fund's capital. That is simply a bullet that pro-dividend supporters have to bite. It should be clear, though, that this bullet involves a reallocation, not a dilution, of returns—the choice to distribute some income-producing capital to individuals is a reallocation of this capital and not a dilution of its ultimate return-producing potential.

### *C. Savings Objection*

Part of what underpins the anticonsumption and diluted returns objections is the idea that SWFs are first and foremost savings vehicles for the citizen body as a *collective*. Individuals have a right to benefit from this wealth but *vis-à-vis* their membership of the community, not in their capacity as private individuals. Even if private rights to this wealth are found to exist, such rights would be trumped by jointly held rights to this common wealth. This is reflected explicitly in the establishing documents of many SWFs, which conceive of SWFs as national savings funds set up to ring-fence capital to help meet long-term community liabilities.<sup>20</sup> For instance, in Australia's case the Future Fund was set up to meet a specific long-term *savings* challenge—the funding of commonwealth public servant pensions from 2020 that current projections say the government is not equipped to meet. If the fund is not drawn down for this purpose, it may be used to meet broader savings-related challenges implied by Australia's fiscal profile. According to the head of the Future Fund, David Murray, Australia is a “savings short” nation in three senses:

On current projections, although Australia is better placed than many mature OECD economies, Australia has not fully provided for their superannuation liabilities, mostly across the private sector;  
The ageing problem poses the dual challenge of a shrinking tax base and increased government expenditure to meet the needs of an ageing population;

The ratio of working population to land mass in Australia leads to limited capital formation capacity given its small workforce relative to the very large resource base. To minimize dependency on capital importation, Australia needs to raise its savings, particularly in light of the current position of high net foreign liabilities.<sup>21</sup>

These challenges are *national* in character. While individuals may ultimately be beneficiaries of sovereign wealth, the problems that these funds are set up to redress are first and foremost community challenges (ageing population, intergenerational wealth inequity, depletion of resources). Other SWF home nations face similar long-term pressures, partially explaining the rapid proliferation of SWFs in the past decade to augment national wealth holdings.<sup>22</sup> It is this characterization of SWFs as *national* savings funds from which the antidistribution position derives much of its force. On this conception, the idea of private individual dividends clashes with the commonplace view of SWFs as collective public entities.

The main response to this objection is to note that SWFs can both spend *and* save, albeit subject to some trade-off. Put another way, legitimate saving goals constrain dividend distribution, but do not wholly preclude it. For evidence, we can point to the APF, the one SWF that does distribute dividends, yet also achieves its savings targets. As its name implies, the APF was established to make permanent the temporary resource windfalls of Alaska. The dividend payment was introduced mainly as a tool to build a political constituency for the APF. Even with a generous distribution program that has seen 50.7 percent or \$18.8 billion of the fund's income paid out in dividends since the PFD's inception, the fund still managed to save 49.3 percent or \$18.3 billion of its income for future generations.<sup>23</sup> Indeed, dividend distribution has not prevented the fund growing from an initial investment sum of \$734,000 in 1977<sup>24</sup> to approximately \$37.1 billion in 2010,<sup>25</sup> making it larger than any endowment fund, private foundation, or union pension trust in the United States.<sup>26</sup>

This is partly the result of a well-designed fund with effective governance mechanisms. In particular, the fund is comprised of two parts: nonspendable (principal) and assigned (realized income) capital. The fund observes the goal of "principal protection" by mandating that the principal sum earned from resource revenues must never be used to fund dividends and is accordingly designated "nonspendable." In turn, the nonspendable portion of the fund is invested permanently and cannot be spent without amending the state constitution.<sup>27</sup> In

contrast, realized returns earned on the invested principal may be spent and are used to fund dividends. As on June 30, 2010, the nonspendable principal of the fund totaled \$33.6 billion,<sup>28</sup> while the assigned capital dividend funding and inflation transfers stood at just \$1.2 billion or only 4 percent of the fund.<sup>29</sup> Again, the Alaska model demonstrates that there is no prima facie reason an SWF cannot achieve both tasks, of accumulating national savings and distributing dividends to individual beneficiaries. If one task is a higher priority than the other, then the fund design can take this into account and be weighted more toward accumulation or distribution accordingly.

#### *D. Technical Concerns Objection*

A closely related aspect of the savings objection is a technical concern with the macroeconomic consequences of dividends and accordingly may be labeled “the Technical Concerns” objection. A dividends critic may accept that, in principle, an SWF can save and spend, yet still be concerned about the technical consequences of dividends. As noted SWF analyst Andrew Rozanov argues: “One of the problems with directly distributing excess commodity revenues to citizens in the form of individual pay checks is that it offsets some of the anti-Dutch Disease effects of SWF saving and management.”<sup>30</sup>

Rozanov’s concern, which echoes that of several major funds, is that dividend distribution might impair an SWF’s ability to deliver the macroeconomic benefits of constraining currency inflation and preventing decline in the manufacturing sector that can accompany resource booms. A detailed technical analysis of dividends is beyond the scope of this chapter, but it is sufficient to note one technical point here: if one accepts a cyclical view of the business and economic environment, then this is an argument for adjustable dividends rather than no dividends. In a cyclical environment, there are times of contraction when a higher rate of spending from government fiscal sources (like an SWF) is appropriate. These are interspersed with boom times when there is greater pressure on government to retrench in order to avoid aggravating an overheated, inflationary economy. During such times, government should save through higher tax intake and lower spending to build up a buffer for the next inevitable downturn. It follows then that in times of downturn, government spending through SWF-funded dividends may be an entirely appropriate Keynesian policy tool to help stimulate demand. Equally, when the economy is booming and private sector demand is sufficient, then government spending schemes such as dividends may need to be curtailed. The

latter could be achieved by suspension of the dividend program and preservation of that year's dividend capital in the SWF until conditions are right for recommencement.<sup>31</sup> This approach is similar to the fiscal management of interest rate levels by central banks. On a cyclical view of macroeconomic conditions then, unqualified permanent opposition to dividends is not environment-sensitive. It risks overlooking a possible policy lever for government to respond to cyclical macroeconomic conditions.

A related aspect of the technical concerns objection is that dividends are only desirable when funded by *actual* savings in an SWF. According to Martin Skancke, the then director general of the Norwegian Ministry of Finance, "running a budget surplus is the only way a government can accumulate financial assets on a net basis. If a [sovereign wealth] fund is set up with an allocation rule that is not linked to actual surpluses, the accumulation of assets in the fund will not reflect actual savings."<sup>32</sup> Accordingly, the Norwegian Petroleum Fund only receives allocations when the budget is in surplus. This has meant that despite the petroleum fund's establishment in 1990, the first transfer to the fund took place only in 1995 after Norway had come out of recession.<sup>33</sup> Otherwise, the Norwegians argue, the government is being forced to borrow money to cover allocations to the fund. For this reason Skancke rejects the Alaskan dividend model. The PFD program runs irrespective of whether the State of Alaska is in surplus or deficit. Every year, at least 25 percent of mineral resource revenues must be put into the fund, regardless of whether Alaska can balance its budget. During several years over the past decade, the APF has grown while the state budget of Alaska has faced deficits.<sup>34</sup> Despite a deficit in 2000, the legislature appropriated an extra \$250 million for the permanent fund principal from the earnings reserve.<sup>35</sup> From the Norwegian perspective, such an arrangement means the APF is not achieving its purpose of being a *savings* fund. The savings are built on a fiscal illusion of surplus where the obligation to pay dividends becomes detrimental to the long-term financial health of the state. The legislature becomes constrained, as the dividend becomes an expected component of individual's income. An October 2003 poll by Dittman Research Corp. found that 64 percent of Alaskans believed that they were entitled to their dividend, even if Alaska has a budget deficit.<sup>36</sup> As Skancke argues, "the real issue is whether there is any higher public support for net, as opposed to gross, asset accumulation. It does not help much to protect the oil fund if debt is being accumulated elsewhere."<sup>37</sup>

If popular support favors net asset accumulation, dividend schemes must only be paid out in years with fiscal surplus. This is a design issue. It is not a reason to oppose the implementation of dividends, but it does demand that a polity determine how they weight the rights of future generations over those of current generations. If a country's anticipated future growth and government revenues are lower than expected, it may be desirable to offer higher protection to future needs than current public outlays.<sup>38</sup> In this case, the Alaska dividend model, insofar as it declares the principal as nonspendable and only distributes returns on investment, is an acceptable model. Otherwise, a fund may be designed with a similar allocation rule to that of the Norwegian Petroleum Fund but which also allows expenditure of the fund's real returns on dividends.

Skancke offers two further objections to this proposal. First, he argues that current Norwegians are already receiving a dividend, since every year the GPFG transfers an amount corresponding to the "amount of petroleum revenues used in the fiscal budget to cover the non-oil deficit" to treasury.<sup>39</sup> While in some senses true, equating this type of budget transfer with a direct cash dividend payment is tenuous, as a general national surplus will never be viewed by ordinary citizens in the same manner as a direct cash transfer into their own hands. Even if these budget transfers have the potential to lower interest rates and taxation, the psychic effect of cash transfers on the individual are often stronger as cash offers a greater level of perceived autonomy to the recipient and immediate benefit to cash flow. Budget surpluses also fail to create the necessary proximity between an individual and savings that inspire a sense of responsibility for the fate of capital that, in turn, can encourage further saving.

Skancke goes on to argue that "If [government] has decided to give the population direct access to the [resource] cash, then the choice is between tax cuts or cash dividends. I would argue that tax cuts, in terms of economic efficiency, are better . . . If you paid a direct cash dividend, for any given level of spending, you will have to increase taxes . . . If you think that taxes are distorting, you would prefer to give priority to tax cuts."<sup>40</sup> For Skancke, the preference is to reduce tax burdens by spending oil revenues in government budgets to avoid future tax hikes. But this comes down to individual perspectives on tax cuts versus dividends. As Skancke himself observes, he is only considering this issue on efficiency, not equity, grounds. If justice trumps efficiency, it may be worth some loss of efficiency if the positive effects on income distribution are significant. Moreover, the distorting effects of

taxation may be exaggerated since other effects in contrary directions, such as on labor supply, might cancel each other out.

David Murray of the Australian Future Fund considers dividends more appropriate than tax reductions under certain conditions, namely, if real capital is preserved and there is no net debt. He suggests dividends could take the form of a direct deposit into individual's own investment portfolios or pension funds, a model explored in chapter 13 of this book.<sup>41</sup> Again, this reinforces that the design of individual SWFs must reflect the macroeconomic needs, fiscal profile, and policy preferences of individual countries. Technical concerns are not arguments against SWF-funded dividends per se, but rather arguments for a particular set of preferred policy outcomes that dividends may or may not help achieve.

## 2. CONCLUSION

This chapter reviewed four common objections offered by SWFs to the proposal of a dividend scheme. None of these objections offered a decisive defeat of the dividend proposal in principle or practice. They were shown to be founded either on simplistic assumptions about individual and institutional financial behavior or employed misguided conceptions of ideas core to dividend schemes. Both the anticonsumption and diluted returns objections suffer from misguided interpretations of how dividends work. The savings and technical concerns objections expressed valid reservations about dividends hamstringing the core macroeconomic purposes of SWFs. However, the savings objection exaggerated the mutual exclusivity of saving and spending goals, while the technical concerns objection simply underscored that SWFs and dividend programs need to be carefully designed, not that dividends are inherently problematic for countries wishing to achieve savings goals.

The question then arises as to why this antidistribution preference exists throughout the diverse SWF community if the core claims supporting this position are not compelling. This chapter speculates that such objections may be a rhetorical front for a shared, yet independently formed, institutional preference within SWFs for centralized control over SWF capital. That is, managerial elitism may explain a desire to preserve maximum control over SWF assets under management. If so, exaggerating the downside of dividends serves as useful justificatory tool for current SWF arrangements. By questioning the validity of SWFs' dividend anxieties, whether sincere or the result of managerial territoriality over sovereign wealth, the persuasive case for exporting Alaska-style dividends is hopefully bolstered.

## NOTES

1. For helpful comments, I would like to acknowledge David Murray, Andrew Rozanov, Martin Skancke, Karl Widerquist, Michael Howard, Gary Flomenhoft, Stuart White, Matthew Brown, Christian Westerland Wigstrom, the participants of the February 2011 North American Basic Income Guarantee Conference in New York and the April 2011 “Exporting the Alaska model” workshop at the University of Alaska, Anchorage.
2. I thank David Murray for these points.
3. The majority of interviews with SWF representatives were conducted at the May 2010 meeting of the International Forum of Sovereign Wealth Funds (IFSWF) in Sydney, Australia. Most interviews were conducted on a confidential basis. The four distinct objections set out here were compiled by the author based on various reservations and concerns expressed during these confidential discussions. If further points in the text are drawn from these interviews, citation occurs. Nonconfidential interviews and interviews conducted at times other than the IFSWF meeting are cited accordingly.
4. Opposition to dividends by these states was confirmed by SWF representatives during interviews. SWF Officials, Personal Interviews, May 9, 2010. [
5. Alaska Channel 2 News 2009.
6. Harrison 1999, 81–91.
7. Hsieh 2003, 397–405.
8. Hsieh 2003, 401.
9. Goldsmith 2010, 10; Goldsmith 2005, 553–56.
10. Goldsmith 2010, 10.
11. Goldsmith 2010, 10.
12. Goldsmith 2010, p. 11.
13. Goldsmith 2010, 10.
14. Norwegian Ministry of Finance 2009, 15.
15. One could question this claim if the long-term trend of stock portfolios is typically upward. If the market rebounds, then the stock is only lost temporarily, not destroyed. But this does not change the fact that at any given point in time, losses on an investment fund do amount to capital destruction. Nothing is gained in return, in contrast to an individual’s consumption of the dividend, which typically results in the acquisition of a good (except in the case of, say, gambling or illicit purchase of drugs where it is more difficult to make the case that something worthwhile is acquired or the economy is stimulated in a desirable manner). In contrast, in any market downturn, investments risk a negative return, which ultimately has to be regained in the next year of trading. While stocks may recover, they would have been worth even more without the downturn, so there is still a sense of capital destruction at play.

16. For instance, the standard remuneration formula for hedge funds and mutual funds is the “2–20” rule: 2 percent of assets under management and 20 percent of profits above a predetermined benchmark, which is significant when dealing with the billion-dollar holdings of SWFs, which are increasingly moving into alternative asset classes such as Hedge Funds. SWFs are also vulnerable to the criticism that substantial capital has been lost through expensive active management fees, a fund management style aimed at generating “alpha” returns that beat index performance. A 2009 evaluation of the impact of active management versus passive (index) management commissioned by Norway’s GPFG finds that for “institutional investment sectors, such as large-scale endowments, pension funds and sovereign funds, there is [little] evidence about the capability of active management to generate positive risk-adjusted returns . . . Most research suggests that pensions fund managers are not able to identify top managers ex ante and the managers that serve the pension fund sector show little evidence of skill on a risk-adjusted basis. The few studies of sovereign fund trades in public securities provide evidence that, while stock prices respond positively when a sovereign fund invests, *the long-term performance of these investments is not particularly good*” (emphasis added). See Ang et al. 2009, 12 and 51–52.
17. Tang 2009.
18. SWF Official, Personal Interview, May 9, 2010.
19. “The Permanent Fund Dividend,” Alaska Permanent Fund Corporation 2010a.
20. For a summary of SWF founding documents, see Appendix III of the International Working Group of Sovereign Wealth Funds 2008, 31–49.
21. Murray, February 2, 2010.
22. There are currently about 50 SWFs globally, with two-thirds of these created since the year 2000.
23. Alaska Permanent Fund Corporation 2010b, 2.
24. Today’s inflation-adjusted value of the initial seed figure is \$2.7 million. While the APF has historically earned over 10 percent, these figures imply an annual growth of roughly 34 percent. The discrepancy is explained if we recall that the APF is augmented each year by at least 25 percent of Alaska’s resource royalties in any given year and the unrealized returns on investments (that is, the market value of investments not yet realized). Realized earnings (such as stock dividends, bond income, rent, etc.) from investments are used to fund the PFD. See “About the Fund,” *Alaska Permanent Fund Corporation* 2010a. There were also several special appropriations by the legislature, including \$1.8 billion in surplus oil revenue in 1981, an additional \$1.26 billion in 1986, and several hundred million dollars more in the following years. See Olson 2006, 165
25. Alaska Permanent Fund Corporation 2010b, 2.



26. "About the Fund," Alaska Permanent Fund Corporation 2010a.
27. The State of Alaska Constitution requires at least 25 percent of certain mineral royalties received by the State to be placed into the principal of the fund. This amounts to approximately 10–12% of total revenues from state resources. See Alaska Permanent Fund Corporation 2010b, 4 and 29.
28. This is the total nonspendable principal as on June 30, 2010. See Alaska Permanent Fund Corporation 2010b, 24.
29. Alaska Permanent Fund Corporation 2010b, see graph on 16.
30. Monk 2010.
31. Dividend proponents concerned with income stability would likely object to the idea of adjustable dividends.
32. Skancke 2003, 320.
33. Skancke 2003, 318.
34. Alaska faced possible deficits in the 2008–2009 and 2009–2010 budget cycles, requiring draw downs on other reserved funds in both periods to avoid deficits. However, the APF's earnings first exceeded the state's general oil royalty and tax revenue in 1998, as it earned revenue of \$2.6 billion with assets of \$25 billion. See Olson 2006, 166.
35. Anderson 2002, 63.
36. Lewis 2004, 81.
37. Skancke 2003, 321.
38. Skancke 2003, 320.
39. Skancke 2003, 321–322.
40. Skancke 2010.
41. Murray 2011; Widerquist chapter 13, this volume.



Room for Improvement? Assessing  
the Strengths and Shortcomings  
of the Alaska Model in  
Advance of Export

*Alanna Hartzok*

When considering the question of whether or not the Alaska model can be applied on a worldwide basis, it is necessary to consider both the strengths and shortcomings of the Alaska Permanent Fund (APF) and Permanent Fund Dividend (PFD) as currently constituted. While several components of the APF and PFD could and should be replicated elsewhere, there are a few important aspects of the fund that need to be modified when applied to establishing similar new agencies elsewhere. Let us first consider the several positive aspects of the fund that should be retained when establishing new funds.

The legality of the fund is firmly embedded in what Wally Hickel, the second and eighth governor of Alaska, termed an “owner-state” approach to governance. As stated in the Alaska state constitution: “The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people.” Provisions in Alaska’s constitution require that the state’s commonly owned 103 million acres of state land and resources be used for the maximum benefit of the people of Alaska.<sup>1</sup>

The process of establishing the fund was broadly democratic. Following a period of public debate and input, in 1976 voters approved a constitutional amendment, proposed by Governor Jay Hammond

and modified by the legislature, stating that “at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue-sharing payments, and bonuses received by the state shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments.”<sup>2</sup>

However, the revenues listed here amount to less than half of *all* the oil revenue the state receives. The 25 percent constitutional provision has only amounted to 11–12 percent of oil revenue going to the APF. The legislature has made additional ad hoc deposits into the APF to bring that total over 18 percent, but it’s still quite a bit less than 25 percent of all oil revenues.

There is a high degree of transparency concerning both the administration of the fund and investment details. The APF’s easily navigable website is up-do-date, educates the citizen about the fund, and permits questions to be asked, to which staffers respond individually.

The right to receive dividend payments is determined by the simple requirement of one year of residency in the State of Alaska. A person may leave the state for purposes of education or military service as long as he or she does not take up permanent residency elsewhere. He or she must return to Alaska every two years and remain in the state for at least 72 consecutive hours in order to continue to be eligible for the dividend. The annual citizen dividends, gleaned from interest payments accruing from the fund’s investment portfolio, are sent in checks of equal payments to everyone meeting this requirement.

As the dividends provide a significant amount of additional income for individuals and families, there is strong citizen interest in, and support for, the fund. Since the other 81.8 percent of Alaska’s resource revenue funds most of the state’s budgetary requirements, Alaska does not collect state sales tax or personal income tax, further enhancing the financial capacities of the citizenry.<sup>3</sup>

There are other important elements that enable the PFD program to function and that are rarely mentioned in the literature. Alaska, as is true of most of the “developed” world, has an enabling postal, banking, and information technology infrastructure. Without a postal system capable of providing accurate name and address information, surety that checks will be delivered to recipients in a timely manner, and a banking system that enables checks to be cashed, the dividend program could not have been administered in a fair and efficient manner.

All of the above features should be replicated when establishing new resource rent-based dividend funds. The only exception is that

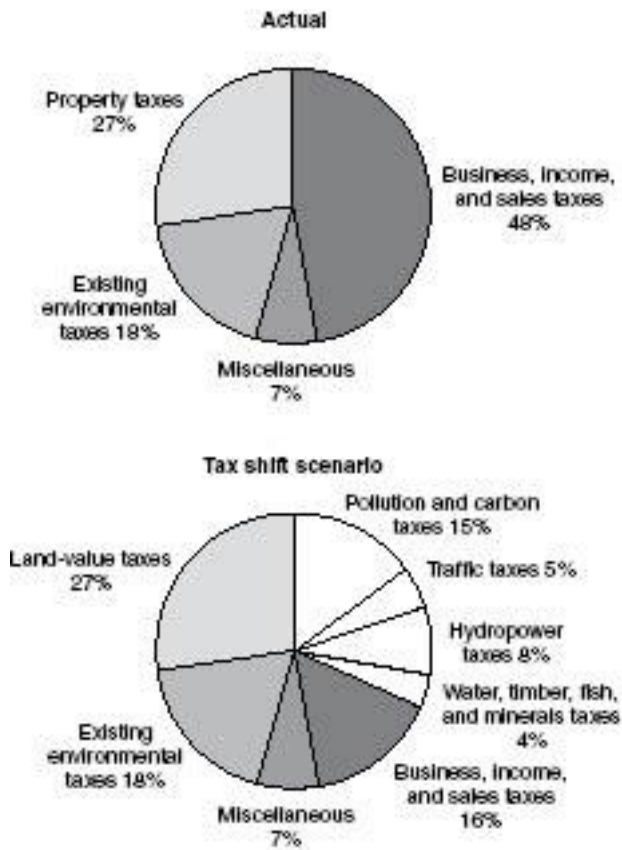
the decision to allocate “at least 25 percent” of resource royalties and mineral lease rentals is specific to the APF. Decisions regarding the exact percentage of how much revenue should be placed in a permanent investment fund versus how much is to be utilized to finance state budgetary needs should be made on a case by case basis, with a requirement that such decisions be made via broad citizen input. Additionally, rather than fixing the percentage thereafter, this decision could be reviewed periodically, perhaps every five years, and modifications would then be made, again after a period of broad citizen participation in the decision-making process.

Citizens should not only play a significant role in determining the percentage of resource rents and royalties to be used to finance government budgetary needs versus the amount to go into dividends, but also provide inputs in determining those government budgetary needs. We now have working examples of this in the growing peoples’ budget movements in Brazil and elsewhere, as described by Deborah Brautigam, whereby citizens vote for line items of up to 50 percent or more of their city’s budget.<sup>4</sup>

A “best practice” model for future funds would be to monitor and inform regarding the exact mechanisms and formulas used for determining the amount of resource rent being collected. This methodology should also be reviewed and revised on a periodic basis. Best practice models can also be established based on the experiences of other currently functioning resource rent or “sovereign wealth” funds. “Experiences with Oil Funds: Institutional and Financial Aspects” is one such excellent report provided by the World Bank group.<sup>5</sup>

Since the establishment of the APF more than 30 years ago there have been conceptual breakthroughs regarding how this type of fund fits in with what could be called a “holistic integrated ” paradigm of public finance. One of the best models was first put forth by Northwest Environment Watch (now Sightline Institute) and included several other resource rent domains, such as taxing emissions into air, water, or soil; surface land sites according to land value; charging fair fees for water, timber, fish, and minerals extraction. The goal is to “tax bads, not goods” by utilizing the incentive mechanisms of tax policy to augment social and environmental betterment. Gary Flomenhoft’s “Vermont Green Tax and Common Assets Project” provides a more recent and impressively detailed green tax shift model.

Those leading movements to establish future resource rent funds should familiarize themselves with these holistic and integrated approaches in order to bring to the fore the new economics paradigm



**Figure 4.1** A green tax shift for the Pacific Northwest

for public finance policy. Once the blueprint is in place conceptually, the details for implementation can be fleshed out step by step and stage by stage. Figure 4.1 shows the diagrams of the tax structure of the Pacific Northwest and the proposed “green tax shift” compiled by Bauman and Durning.<sup>6</sup>

The lack of a holistic green tax shift paradigm accounts for weaknesses and flaws in the APF model. The fund is frequently criticized by environmentalists who maintain that distributing dividends sourced from petroleum aligns the people with the interests of those engaged in polluting, nonrenewable extractive industries. There is likely some truth in this as the preservation of Alaska’s natural heritage, such as

the Alaska National Wildlife Refuge, could reduce the opportunity for Alaskans to increase the APF and hence the amount of their dividends. A carbon tax or other green tax on the environmental degradation often caused by resource extractive industries might also reduce the incentives of corporations to operate in the state. But without a commitment to shifting to renewable forms of energy, Alaskans may end up with higher energy costs and worsened environmental conditions in future. Utilizing a substantial portion of oil rent to invest in the shift to renewable energy, either developed by the state or via low interest loans to the private sector, would address this concern.

Capturing surface land rent for funding dividends might be a much better approach overall. Surface land is, of course, also a commons. Land value taxation (capture) policy can be understood as a fee for private enclosure of surface land. As demand increases for prime land sites the value of land steadily increases. As a community grows, as schools are built, and as transportation, sanitation, and other infrastructure is put in place, the value of land increases.

However, in most places in the world this increase in land values accrues to landowners only, while those seeking to buy land must pay an ever higher price and face higher mortgage payments as a result. The better the location or the greater the amount of land owned, the more landowners benefit. Landowners may be local or absentee, individuals or financial services, such as real estate investment trusts holding land for the purposes of profiteering and speculation. To create a fair economy we must realize that land value is socially created, and thus a commons asset, and it should be used to benefit society as a whole via financing public goods and services, direct dividends, or some combination of the two. Earth Rights Institute hosts an excellent online course called “Land Rights and Land Value Capture” that details these principles and policies.

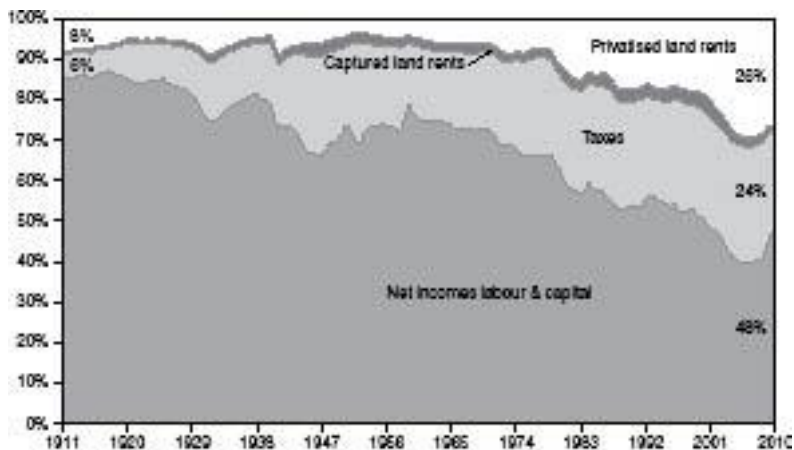
While dividends increase the amount of funds in people’s pockets, when land values increase faster than wages, then the proportion of citizens’ wealth spent on housing and other basic needs will increase, essentially sopping up the purchasing capacity gained by the dividend.

Classical economist David Ricardo described this phenomena in his writings on the “law of rent,”<sup>7</sup> an important line of thought further developed by Henry George in his masterwork *Progress and Poverty*. Because of this effect, dividends sourced from a commons domain other than surface land value should always be combined with a land value taxation public finance approach.<sup>8</sup>

Alaska’s constitutional mandate—that all the natural resources of Alaska belong to the state to be used, developed, and conserved for the maximum benefit of the people—should be understood to include surface land. Land rent is likely to be a significant source of funds that could be shared by the people of Alaska, especially when the oil runs dry. Researchers in Australia have calculated that this largely untapped potential source of dividends is as high as one-third of GDP. Figure 4.2 shows that (1) public finance drawn from land rent can provide a sufficient source of funds for public needs; (2) as a proportion of GDP, resource rent increases while returns to labor and production decline, thus validating the functioning of the law of rent; and (3) dividends from oil and other extractive resources will assuredly and steadily result in an increase in surface land rent as does any other increase in purchasing capacity and productive power.

Specifically, the graph depicted in figure 4.2, designed by Land Values Research Group from the research of Terry Dwyer, depicts Australia’s gross domestic product descending into an economic depression because a badly designed tax system has finally choked off effective demand—almost completely. This unique portrayal separates earned incomes from unearned incomes and closely approximates what has taken place in other economies.<sup>9</sup>

The terms “land value taxation,” “land value capture,” and “site value rating” all reference the public charge of a fee for use of surface



**Figure 4.2** Changes in GDP distribution over 100 years: Australia



land in lieu of taxes on homes, buildings, wage income, and production of goods and services. Not only is the potential public revenue from surface land rent significant as an amount, the incentive effects are impressive. For example, when surface land rent is collected for social benefit:

Land is freed from socially harmful incentives for profiteering and land speculation, and thus maintains affordability.

Affordable land means more people in a locality can access land upon which to labor by establishing local businesses, building homes, growing food, and securing energy from the sun, wind, and wood.

When land costs are lowered and remain stable, more funding is freed for capitalization of local businesses, whether they be cooperatives, community corporations, or individual or family owned businesses. Lower land costs mean lower mortgage payments as well.

Land rent is a substantial sum that can pay for education, health care, and other public infrastructure.

Urban land sites are better utilized. Sprawl is curtailed because this public finance approach encourages “infill development”—the utilization of vacant and other underutilized land sites.<sup>10</sup>

It is important to understand that APF dividends are drawn from the interest accruing to the *investment* of the state’s oil revenue. The structure of the APF investment portfolio may well be the most problematic component of the APF model. The “Investments” section of the Alaska Permanent Fund Corporation (APFC) website states:

The investment goal of the board of trustees is to produce an average annual real rate of return of 5 percent over the long term. To achieve the target return, each year the trustees set a target asset allocation that determines the types and percentages of investments.

Over 30 years the trustees have gradually guided the fund from a portfolio entirely in bonds to a portfolio that is diversified across asset types. As new investment opportunities appear, the trustees evaluate these investments to determine if they will fit within the fund’s risk and return targets.

Fund assets are invested to earn income. As all investments carry some degree of risk, the fund is invested prudently to reduce the risk.

This section of the APF website also tells us that Alaska’s constitution and state law set out certain requirements for the fund’s investments:

The fund can only invest in income-producing investments.

The goal of the fund’s investments should be to maintain the safety of principal while maximizing total return.

All investments must conform to the prudent investor rule. This fiduciary standard requires that investment decisions be made with the prudence, intelligence, and discretion expected of an institutional investor.

The fund is now so large—\$39.9 billion as of March 31, 2011, according to the APFC website—that it has the power to capture significant amounts of resource rents and other unearned income from throughout the world. Within established foundation guidelines of the “prudent investor rule,” the trustees’ goal is to earn slightly better than average rates of return with slightly below-average levels of risk. In other words, the fund is managed under normal investment procedures and criteria. And under normal investment rules, there are no established criteria for socially or environmentally responsible investing. In fact, the fund makes a special point that it minimizes risk and within that constraint maximizes investment yield and does *not* engage in “social” or “political” investing.

Established to secure common heritage rights to rents and royalties from the oil and natural resources of Alaska for the citizens of Alaska, the APF now draws resource rents from other territories. In other words, mandated by law to secure the continued prosperity of the citizens of Alaska now and into the future, the fund receives substantial payments from land and natural resources worldwide via fund investments in real estate and stocks, as profits from the latter also include substantial amounts of land and resource rent. The author of this chapter had first written about this concern in an earlier work on the APF: “The Alaska Permanent Fund: A Model of Resource Rents for Public Investment and Citizen Dividends.”<sup>11</sup>

Although the fund states that it does not engage in social or political investing, the fact is that its status quo investment approach does indeed impact the social and political realities of people throughout the world. The APF website tells us that stocks are held in 59 countries and 60 sectors, including in oil, gas, coal, and rubber. For example, the fund has made substantial investments in ExxonMobil and Chevron. Both companies have major investments in Nigeria, a country where most of the people live in dire poverty.

A Xinhua News Agency story tells us that “ExxonMobil has disclosed that it is investing over 2 billion US dollars annually in the exploration and production of oil and gas reserves in Nigeria.” But the company is not abiding by its agreements to hire and maintain indigenous workers. According to Sahara Reporters:

The domination of the Nigerian oil industry by foreigners came under attack today as the Petroleum and Natural Gas Senior Staff Association of Nigeria (PENGASSAN) in Mobil Producing Nigeria (MPN) commenced an indefinite strike over the sacking of 84 Nigerian oil workers by the company. The workers, numbering hundreds, blocked the gates to the Qua Iboe Terminal at Ibeno, Akwa Ibom, as they reported for work at the facility.

The Nigerian oil workers in ExxonMobil’s Nigerian unit began the showdown with the management arguing that the sacking of indigenous workers in the guise of cost-cutting is against Nigeria’s national interests and leaves the oil sector in the hands of expatriates.

They are accusing the oil firm of discriminatory labour practices that favour expatriates at the expense of indigenous manpower. The labour leaders said they were compelled to embark on the strike because the management of the oil firm sacked the affected workers unilaterally, without consulting the union, in violation of laid-down procedures.<sup>12</sup>

Regarding the “investment climate” in Nigeria, Amnesty International reports about Chevron in Nigeria:

Ten years after the internationally condemned executions of the “Ogoni 9,” including Ken Saro-Wiwa, the legacy of human rights violations in the Niger Delta continues. Amnesty’s recent report, “Claiming rights and resources: Injustice, oil and violence in Nigeria,” calls particular attention to the human rights violations and failures of the Nigerian government, Chevron Corporation (CVX) and Shell Oil . . . Despite video of beatings and independent observers accounts of violence, Chevron (CVX) has not lived up to its human rights responsibilities.

On the plus side, everyone in the world can view APF investment details, including addresses, maps, and photos, on the APF website. All public institutions and corporations should display such a high degree of transparency.

Ultimately, the only rational, supportable, moral, just, and ethical basis upon which the citizens of Alaska can assert a claim to the oil resources of Alaska is by birthright to the gifts of nature. And that cannot be an exclusive claim. The claim by birthright can only be

legitimate if it is acknowledged that all other human beings have an equal claim to land and natural resources. The deepest ethical dimension of territorial rights recognizes that humanity is one and indivisible in its fundamental claim to the earth as a birthright of all.

Therefore, the citizens of Alaska would do well to hold public forums to review APF investment criteria. They could consider establishing a broad humanitarian role for the fund in addition to the prudent investor rule. A potential outcome of such forums could be new directives requiring managers of the fund to invest (1) in the development of renewable energy technology; (2) in strictly goods and services businesses and industries; and (3) in places and in ways that would support the emergence of forms of governance holding principles aligned with the primary goals of the fund, that is, the collection and distribution of resource rent as a common heritage right for all people on an equal and democratic basis.

New resource rent funds, if they intend to distribute dividends from an investment portfolio, should be based on socially and environmentally responsible investment criteria. Portfolio investment managers can either develop their own protocols or simply place their investments with funds that have sustainable and responsible investment screens, such as Calvert Investments.

Our criticism of the APF is not meant to detract from the fact that it is a very important (and the world's only) example of a state owned resource rent or "sovereign wealth" fund that distributes annual dividends. We have much to learn from both the strengths and the shortcomings of the APF as we work to establish new institutions that collect and fairly share the value of our local and global commons.

Let us be clear that governments should recover the maximum amount of the rent of extractive resources, meaning the surplus value beyond the costs of labor and capital. Governments should also establish, monitor, and enforce environmental standards. Rent recovery can pay for these safeguards. A first step is to determine the specific amounts that corporations are currently paying governments for access to oil and other natural resources and how those funds are being spent. An unfortunate reality is that in a number of countries corrupt politicians are squandering the royalties that companies pay their governments. Information transparency, as promoted by Transparency International and others, will drive the next steps in forming resource rent funds.

NGOs and other citizen-based organizations need to apply the same pressures for transparency to surface land, mapping who owns what land where and determining its value in terms of locational and

other advantages. Calculations can give a rough estimate of how much could be available for citizen dividend payments, giving impetus for movements to implement land rent capture/land value taxation.

When green taxes and resource rent funds are implemented worldwide, there will be greatly reduced opportunities for people to be exploited by either internal corruption or external predatory forces seeking only to profit from access to natural resources. Governance will take the form of what might be called “earth rights democracy” whereby the needs of the people and the planet’s environment and other life forms are as important as profit, the so-called triple bottom line.<sup>13</sup>

Wars are most often fought over the control of land and natural resources. In order to build a world of peace and plenty, it is urgent that correctly and carefully structured resource rent (aka commons or sovereign wealth) funds that both care for the earth and share the economic surplus be established on all levels from local to global. Percentages of total resource revenues collected could be disbursed up or down these levels based on development criteria, as some nations and regions of the earth are better endowed with natural resources than others. Appropriate tax bases to fund cities, regions, states, and up to the global level can be delineated as described below, with “polluter pay” green taxes levied at each level as put forth by Hartzok in “Green Tax Shift.”

**LOCAL:** Surface land values, such as sites for homes, businesses, and industrial activities, are sufficient to finance cities and towns.<sup>14</sup> Surface land rent commons funds, which can be created by a relatively simple restructuring of local property tax systems, also would be recommended for rural areas where they would advance noncoercive land reform that could underpin the transition to organic farming and a revitalized rural “eco-village” culture.

**REGIONAL:** State, regional, or national bodies committed to transparent and fair governance could and should create resource wealth funds that collect user fees for forest, mineral, oil, and water resources while safeguarding the environment. Precise configurations for the allocation of resource rents between state, regional, and federal levels would vary and should be determined by the discussion and input of citizens.

**GLOBAL:** A Global Resource Agency should be established with a mandate to protect and fairly share the global commons. Many of these territories lie beyond the jurisdiction of national governments and include the fish and minerals in the deep seas, the atmosphere/ozone, the North and South poles, the airwaves, geo-orbital zones,

and other uses of outer space. Competition and exploitation of these territories and resources is fast under way. These vast new frontiers promise great wealth and power to those with the technology to stake a claim. Issues concerning their use and ownership must be addressed at the global level, before disputes over them result in conflicts and warfare. The resource rents of these common heritage domains should be captured for the benefit of all, not pillaged for private profit.

The Global Resource Agency would be responsible for monitoring these global commons, establishing rules and regulations for their use, and levying penalties for their abuse. The Global Resource Agency would carefully calculate the economic rent of these resources and charge and collect user fees. The funds generated from these global resource revenues would be distributed throughout the world based on population, development criteria, and currency purchasing capacity. Revenues collected would also provide funding for global agencies responsible for justice, peacekeeping, fair trade, and sustainable development. We propose that the UN Trusteeship Council be repurposed with this task.

Revenues raised from access fees for the use of global commons could fund sustainable development programs, environmental restoration, peacekeeping activities, or low interest loans for poverty eradication. Funds are also needed on the global level to finance justice institutions such as the World Court and the International Criminal Court and to facilitate policy convergence in areas such as trade, currency exchange, and human rights.

Are there signs of an emerging Global Resource Agency with the necessary legal authority suited to the tasks outlined above? Alas, the nation-state system has not yet agreed to arrangements that would permit the United Nations or any other transnational body to operate with independent funding. But the emergence of such an agency is an imperative if we are to create a world that works for everyone. Places to look for components of a Global Resource Agency include the UN Commission on the Limits of the Continental Shelf, the Law of the Seas Treaty, the Moon Treaty, and the Committee on Energy and Natural Resources for Development.

While some national governments, backed by vested interests that are profiting from the current system, might balk at the idea of a Global Resource Agency, many others would find it a welcome institution if it were truly capable of promoting stability and economic progress for their people. The push for its creation may have to come from a unity of these countries plus a powerful network of nongovernmental organizations, similar to the kind of organizing it took to

establish the International Criminal Court in 1998. Currently, former Irish president Mary Robinson is calling for the creation of a Global Climate Justice Fund.

Dividends could be issued at any or all of these levels, local state/regional and/or global. The exact percentage of the collected resource rent fees to be distributed as dividends or to be allocated for financing public goods and services and/or for environmental restoration should be determined via informed participatory democratic processes. Recent breakthroughs in information technology can greatly facilitate the establishment of commons funds. Compiling accurate information and making it available on websites will require a core of dedicated people from around the world. They will be inspired by the knowledge that their work is to secure the birthright to the earth for each and every person.

In summary, responding to the question of whether or not the Alaska model can be applied on a worldwide basis, the viewpoint of this chapter is yes, but with several key modifications. First, fund-investment criteria should be expanded beyond the prudent investor rule to include socially and environmentally responsible investments. Second, extractive resource-rent-based dividend funds should be established as one component within a holistic, integrated green tax shift approach to public finance policy. Third, as economic development proceeds and surface land increases in value, dividends should be drawn increasingly from this source via land value capture/taxation policies while a substantial percentage of extractive resource rents should fund the development of renewable energy technology.

#### NOTES

1. State of Alaska 1956.
2. State of Alaska 1956.
3. Bankrate's 2009.
4. Brautigam 2004.
5. World Bank Group 2006.
6. Bauman and Durning 1998, 76.
7. Hawes 2010.
8. George 1879.
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What Happens to the Permanent  
Fund Dividend and the Rest of  
Alaska's Unique Fiscal System as Oil Production Continues to Fall?

*Cliff Groh*<sup>1</sup>

INTRODUCTION: AN UNSUSTAINABLE  
FISCAL SYSTEM AND A LOOMING  
UNPLEASANT ADJUSTMENT

The Permanent Fund Dividend (PFD) is the most unusual element of Alaska's unique fiscal system. That system will confront special challenges as a government and economy organized around oil production face both fluctuations in the price of oil and a continuing fall in oil production in Alaska. Despite the popularity of dividends and the aversion to broad-based taxes in Alaska, the state's fiscal structure will be difficult to maintain, particularly as Alaska's oil production continues its decline from a peak reached more than 20 years ago.

For the past three decades, the State of Alaska's fiscal system has featured four critical elements: high state spending per capita relative to national averages; no general statewide taxes on individuals; no use of Permanent Fund principal for anything except generating income; and no use of Permanent Fund income in significant amounts for anything but paying dividends and protecting the Permanent Fund principal from inflation. These four markers of the Alaska fiscal system are highly unlikely to survive for the next three decades.

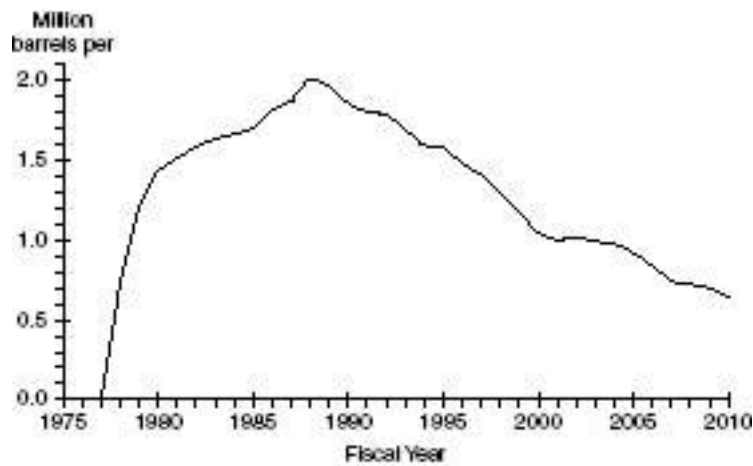
The time of arrival of the day of reckoning is uncertain. The adjustments Alaska will need to make could be pushed off by a number of factors, including continued higher oil prices, a decline in oil production that is relatively gentler than steeper, improvements in technology that reduce the price of producing oil in Alaska, and some much-ballyhooed development possibilities. The probabilities, however, are that the state will face a menu of relatively unappetizing alternatives as its government and economy transition toward structures more familiar to observers from outside Alaska. In that move toward a more “regular” fiscal system, the PFD could get reduced from what it would be under current law or could even be eliminated.

After briefly setting out the problem posed by the decline in Alaska oil production, this chapter lays out the basic options for addressing that problem and then explores four twists on those basic options. The people of Alaska will ultimately need to operate their state government with money that will not come from taxes and royalties on oil and gas production. This chapter looks at four frequently discussed pathways for the state government to get that money. The chapter concludes with some observations about the questions that will help drive choices among the options.

#### THE PRUDHOE BAY CURVE AND THE COMING CRUNCH

The State of Alaska’s long-term fiscal challenge is well known, although many of the state’s residents hold only a hazy understanding of its dimensions. Oil production provides more than 85 percent of the revenue for the Alaska state government and one-half of the jobs in the state.<sup>2</sup> The Trans-Alaska Pipeline System (“TAPS” or “the Pipeline”) carries from Alaska’s North Slope to market 98 percent of the oil produced in this 49th state. More than 2 million barrels of oil per day flowed through the Pipeline at the peak of production in 1988–1989, but the Pipeline now transports approximately 600,000 barrels a day, less than a third of what it carried two decades ago.<sup>3</sup>

Alaska’s heavy reliance on this nonrenewable and steadily declining resource makes “the Prudhoe Bay Curve” a big problem for the state. This phenomenon is named for the supergiant oilfield on the northern slope of the Brooks Range (known as “the North Slope” in Alaska) that is still the largest oil field ever found in North America. Although some smaller fields have been since found on the North Slope, most of the oil that has run through TAPS has come



**Figure 5.1** Alaska North Slope oil production, Fiscal Year 1978 through Fiscal Year 2011

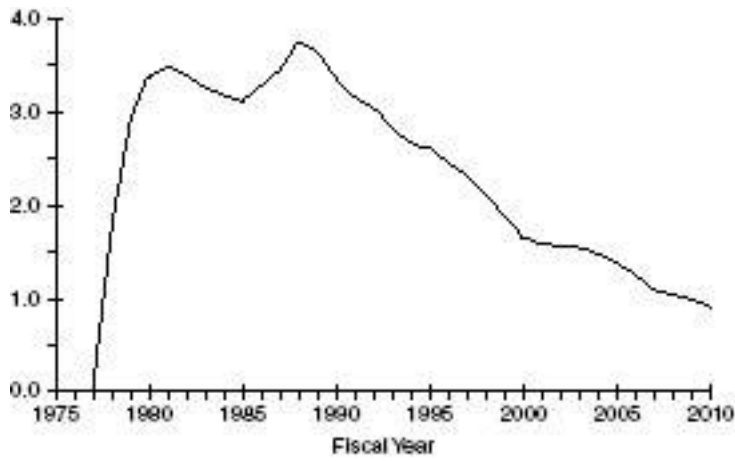
from Prudhoe Bay.<sup>4</sup> The oil flowing through the Pipeline (“TAPS throughput”) went up every year from the opening of the Pipeline in 1977 until 1988–1989, and has dropped every year but one since then (figure 5.1).

Although Alaska’s oil production has fallen steadily for two decades, the 49th state’s population has continued to increase during that period. In 1989 fewer than 540,000 people lived in Alaska; the state had more than 710,000 residents in 2011.<sup>5</sup>

One way to understand how these two lines are moving in opposite directions is to look at how many barrels of oil are produced per day in Alaska per Alaskan. In the middle and late 1980s there were more than three barrels of oil produced each day per Alaskan; as of 2011 that ratio is less than one barrel per day per Alaskan and dropping (figure 5.2).

The problem is shown in starker relief by mapping out annual oil revenues per Alaskan over time, a calculation that also shows the strong effects of the oil tax increases that the State of Alaska adopted in 2006 and 2007 combined with the sharp rise in world oil prices in fiscal year 2008 (the period between July 1 of 2008 and June 30 of 2009) (figure 5.3).<sup>6</sup>

Two other factors make the Prudhoe Bay Curve a particularly difficult problem for Alaska. Outside of the petroleum sector, the



**Figure 5.2** Barrels of oil per day per Alaskan, FY 1977–2010



**Figure 5.3** Real annual oil revenues per Alaskan, Fiscal Year 1978 through Fiscal Year 2010<sup>7</sup>

economy on “the Last Frontier” is thin. Developing a significant tax base in the state unrelated to oil is challenging, partly because the State of Alaska cannot tax the federal government—owner of the majority of the land in the 49th state—and partly because the value of the nonpetroleum resources in Alaska has tended to be low.<sup>8</sup>

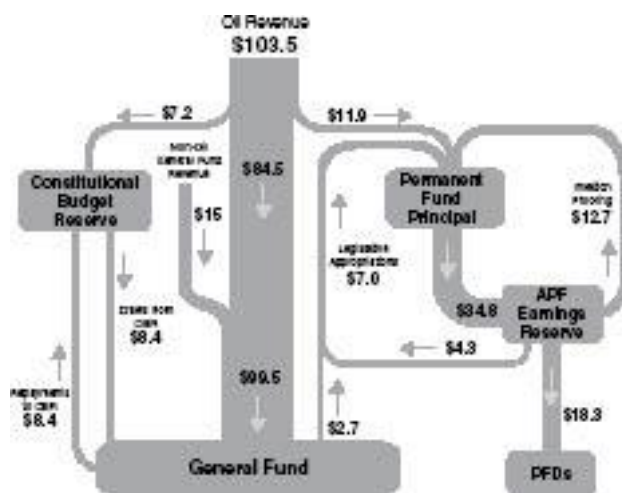
The Prudhoe Bay Curve and the growing state population help create a looming need to change Alaska’s fiscal system. This need

goes by different terms—one common description is Alaska’s “fiscal gap,” defined by one analyst as “the revenue deficit caused by a combination of increased government spending and falling oil revenues as the Prudhoe Bay field went into decline.”<sup>9</sup> A term that fits how this problem will feel to policy makers is “the coming crunch,” and that’s the phrase this chapter will use.

Four features of Alaska’s fiscal system also affect the coming crunch and complicate efforts to address it. The “Alaska Four” are:

1. Relatively high state spending per capita compared to the national average<sup>10</sup>;
2. No general statewide taxes on individuals or significant general statewide taxes on Alaska-based corporations;
3. No use of the Permanent Fund principal for anything except generating income; and
4. Use of Permanent Fund income in significant amounts only to pay PFDs or to protect the Permanent Fund’s principal from the effects of inflation (this latter effort is known as “inflation-proofing”).

Understanding the “Alaska Four” and how they fit into the state’s fiscal system is best done by reviewing the graphic illustrating that fiscal system (figure 5.4).<sup>11</sup>



**Figure 5.4** Cumulative state of Alaska financial flows, Fiscal Years 1977–2010

FACTORS AFFECTING WHEN ALASKA CONFRONTS  
THE CRUNCH: THE BIG BANKROLL, THE  
FLUCTUATING PRICE OF OIL, AND THE TALE  
OF THE TAIL ON THE RIGHT-HAND SLOPE

Although the picture painted so far sounds pretty grim, an optimist would point to an inconvenient fact for a doomsayer. The State of Alaska sits on a mountain of cash. The Moody's rating agency cited the state government's \$14 billion in reserves exclusive of the Permanent Fund principal in giving Alaska an upgrade to a gilt-edged AAA bond rating in 2010.<sup>12</sup> Alaska economic consultant Gregg Erickson's analysis shows that the 49th state's "spendable savings"—that is, cash reserves exclusive of the constitutionally protected Permanent Fund principal—stood at \$17.7 billion as of June 30, 2011.<sup>13</sup> If the Permanent Fund Earnings Reserve Account is also removed from consideration, given that it is the source of the money to pay for both PFDs and Permanent Fund inflation-proofing, Erickson's analysis shows that in mid-2011 the State of Alaska still had \$13.7 billion in available reserves. That lower figure substantially exceeds the 49th state's total annual budget for the 2011–2012 fiscal year.<sup>14</sup>

The surplus shown by the analyses of Moody's and Erickson flows from the higher oil prices since the trough in the early 2000s and increased revenues resulting from higher oil tax rates the State of Alaska adopted in 2006 and 2007.<sup>15</sup> Those two factors have helped cover up the effects of the slide down the Prudhoe Bay Curve and given the 49th state a cushion and an extended reprieve to deal with the decline in oil production.

Oil prices are famously subject to big swings, and—despite appearances to the contrary—some policy makers in Alaska go beyond praying for high oil prices and recognize that such hope can't be the state's only fiscal plan. There appears to be some understanding that oil prices can't keep going up indefinitely sufficiently to make up for dropping production in Alaska, particularly because prolonged periods of high oil prices tend to promote conservation and a search for energy alternatives.

Along with future oil prices, much of the action in determining when the crunch would hit Alaska if the state government did not change its fiscal system lies in how fast production declines and how that decline curve affects the date the Pipeline shuts down. Former Alaska commissioner of revenue Pat Galvin said a few days after he left office in late 2010 that Alaska had already seen "the most aggressive part of the natural decline curve" and that North Slope production

would in the future go down slowly as the curve went through a “long tail.”<sup>16</sup>

Those observers who might be called “production bulls” also hang their hats on a lengthy judicial decision issued in 2010 in litigation involving the property tax on the Pipeline in which the court found that TAPS was likely to remain in operation until at least the year 2047.<sup>17</sup> This conclusion stemmed in substantial part from a determination that the annual decline rate of Alaska North Slope oil production in the future will produce a longer tail on the curve.<sup>18</sup> Although Alaskans have long focused on the importance of the North Slope to the state’s economy and government revenues, they should also pay attention to what might be called the Right-Hand Slope of the Prudhoe Bay Curve. That tale of the tail—as well as the cost of getting oil out of the ground—will help determine whether Alaska’s adjustment to the fiscal gap is a “Big Crash” or a “Slow Squeeze.”<sup>19</sup>

#### CAN DEVELOPMENT OF ADDITIONAL OIL FIELDS, A NATURAL GAS PIPELINE, UNCONVENTIONAL PETROLEUM SOURCES, AND/OR LOWER OIL TAXES PUSH THE CURVE TO THE RIGHT?

Finding the supergiant Prudhoe Bay field on state-owned land in Alaska was a very fortunate event for the 49th state and its residents, and some Alaskans—particularly politicians—say that Alaska will stay lucky. Alaskans make their own luck seems to be the attitude, and Alaskans don’t stay lucky by remaining merely passive anxious observers of world oil markets or simple cheerleaders for a hyperbolic production decline curve aided by judicious use of pipeline heaters to keep the oil moving at throughput below 500,000 barrels per day.<sup>20</sup>

These proactive types—let’s call them “the activist optimists”—tend to focus more on the possibility of government adopting policies aimed at expanding production of petroleum in Alaska. Policies traditionally nominated to achieve this goal have included promotion of a pipeline to take natural gas off the North Slope to market (“the gasline”) and encouragement of more exploration for oil on federally owned lands in Alaska, including the Arctic National Wildlife Refuge (“ANWR”) and—more recently—the Outer Continental Shelf (“OCS”).<sup>21</sup> Discussion has picked up in the past few years about an in-state shorter line (often called “the bullet line”) with a smaller diameter that would transport natural gas from the North Slope to Alaska communities, a project that attracts substantial support not

only for the jobs and government revenues it would generate but also for the lower energy costs it promises to bring to interior Alaska.<sup>22</sup> In 2011, interest has also surged in the possibility that the development of unconventional petroleum resources on the North Slope—particularly shale oil—could put more oil in the Pipeline.<sup>23</sup>

Various obstacles to building the gasline and opening ANWR—and the strong likelihoods that neither would trigger the financial bonanza equivalent to that brought by TAPS—make it difficult to escape the conclusion that the gasline and ANWR are more likely to remain political footballs than economic saviors in Alaska.<sup>24</sup> The State of Alaska is considering providing a subsidy to a natural gas pipeline, a subsidy that might need to run \$4.2 billion or more to provide the desired prices for the in-state consumer.<sup>25</sup> Serious consideration of such a subsidy reflects both the state government's current surplus and the history of government involvement in Alaska economic development as well as enthusiasm about the benefits of the project.

Possibly more promising for Alaska's economy and government revenues are moves to develop unconventional oil resources on the North Slope. Although pundits have discussed for years the potential for development of viscous ("heavy") oil at the West Sak field, more recently attention has turned to shale oil.<sup>26</sup> Alaska has geologically attractive oil-soaked source rocks—primarily shale—deep under the North Slope, and a major technological advance in 2008 has helped make the resources economical to recover.<sup>27</sup> Rising oil prices in 2008 also helped encourage interest in development of unconventional oil,<sup>28</sup> as higher oil prices influence the supply of oil as well as the demand for the commodity. Getting oil out from those source rock deposits generally requires producers to go beyond the drilling of wells required for more conventional oil fields.<sup>29</sup> Instead, producers extracting from source rock usually must fracture and stimulate the rock with substantial volumes of water and sand.<sup>30</sup> Putting a lot of oil from source-rock reservoirs into TAPS will require the resolution of a number of challenges that raise environmental issues, but these prospects appear to provide more grounds for optimism than some other previously publicized proposals for development.<sup>31</sup>

More recently, the focus has been on the efforts led by Governor Sean Parnell<sup>32</sup> and the oil industry to cut the State of Alaska's tax rates on oil production.<sup>33</sup> Oil tax legislation adopted in 2006—and particularly in 2007—included strong progressivity features that sharply increased revenues in comparison to the former tax regime in effect for the previous decade and a half.<sup>34</sup> Advocates of reducing taxes argue that the progressivity features in state oil taxes raise the state's take at



higher oil prices to the point that Alaska is no longer competitive with comparable oil-producing areas around the globe in terms of attracting investment for production.<sup>35</sup> Dogged by criticisms that the tax-cutting proposal will not bring any guaranteed increase in production while definitely causing a substantial drop in tax revenues, the legislation to lower oil tax rates got stalled in the Alaska Legislature before the governor announced in April 2012 that he was withdrawing the bill from consideration in a special session he had called to address it.<sup>36</sup>

Often missed in the debate over proposals to cut oil taxes is the reality that even the champions of the legislation do not envision that such a move could restore TAPS to its previous peak of production. By Governor Parnell's own statements, the goal is not to turn back the clock to the glory days of 1989 when TAPS carried more than 2 million barrels per day. Instead, his hope is that in 10 years 1 million barrels per day would flow through the Pipeline, which would be the level of 2000.<sup>37</sup> It does not appear likely that lower oil tax rates will be the solution to the fiscal problems Alaska will face in the future.

On the other hand, it is difficult to imagine that the State of Alaska could stave off difficult choices for a long time by simply raising oil tax rates again. The major opportunity for the state to have maximized its take from oil production was in the earliest years of the Pipeline's operation, when TAPS throughput was much higher than in recent years and oil prices were often relatively high.

#### WHAT ARE THE ACTUAL OPTIONS FOR WHEN ALASKA DOES FACE UP TO THE CRUNCH?

While politicians and voters are understandably attracted to relatively painless adjustments, it is probable that the State of Alaska will face a fiscal crunch. That crunch will likely be accompanied by an economic recession that will have unpleasant effects. Not all of the effects of the crunch will be terrible for the state's budget—the shrinking of the economy will cause an out-migration that will lead to a drop in the population, which, in turn, will reduce the need for the provision of some public services.

The actual policy responses the State of Alaska will have available to address that crunch are going to hurt. The menu of unappetizing choices includes items that would upset the traditional constellation of the Alaska Four, which, again, are: no use of Permanent Fund principal for anything but generating income; no use of Permanent Fund income in large amounts in the regular budget; no significant general statewide taxes; and high state budgets on a per capita basis.

Actual options for addressing the coming crunch include the following:

1. Cutting the budget far more deeply than has occurred before, leading to cuts that would ultimately leave Alaska well below per capita national spending.
2. Instituting statewide general taxes such as an individual income tax or a state sales tax.<sup>38</sup>
3. Cutting or eliminating inflation-proofing of the Permanent Fund's principal.
4. Reducing PFDs from the baseline set out in current law.
5. Eliminating PFDs.
6. Investing the Permanent Fund principal in significant amounts within the state in hopes of stimulating in-state economic development that would both create jobs and provide a larger tax base.<sup>39</sup>

#### FOUR TWISTS ON THESE BASIC OPTIONS

Beyond these basic options for the State of Alaska, there are variants discussed among policy makers and analysts that combine various elements of political strategy or trading in attempts to make them more likely to be adopted. Discussed below are four of them;

#### ***Pump Up the Permanent Fund's Principal to Facilitate a Slide into Explicit Rentier Status***

Some argue that the State of Alaska should save as much money as possible in the Permanent Fund principal to prepare for the day that the state government would draw on the Permanent Fund's income to pay for public services. This concept is related to "the Cremo Plan,"<sup>40</sup> a proposal that the State of Alaska save all its resource revenues and then draw a fixed percentage from the savings to finance the budget. As a political matter, this plan would have worked better if the State of Alaska had adopted it when large-scale oil revenues started to flow into the state coffers in the 1970s, before the public got used to larger budgets, PFDs, and no general statewide taxes on individuals. As a philosophical matter, a plan to try to finance regular budget operations by using Permanent Fund income as an alternative to raising taxes on individuals can be seen as a gift to higher-income Alaskans who would otherwise be more responsible for carrying the revenue load if the state reinstated progressive personal taxes such as

an income tax with graduated rates. Cutting or eliminating PFDs out of a desire to avoid imposing an individual income tax would impose the costs of the crunch disproportionately on the poorest Alaskans and on children. It is important to note that reductions in dividends only affect Alaskans, while an income tax would be paid by the nonresidents who earn money in the state.

### ***Keep the PFD While Bringing Back the Income Tax***

Under this proposal—championed by former governor Jay Hammond in the last few years before his death in 2005—Alaska would continue to pay out PFDs while also reinstating a common revenue measure for states: the individual income tax (which Alaska had been collecting until repealing it in the first flush of big oil money in 1980).<sup>41</sup> The idea is to have the public receive PFDs and then have the government attempt to “claw back” some of that income received from dividends through an individual income tax. Hammond also proposed doubling the dividend as part of his plan, which would have had the twin effects of further increasing Alaskans’ incomes and giving the government a bigger tax base to try to draw from.<sup>42</sup>

No matter how elegant such a combination would look to academic economists and philosophers, as a practical political matter it would be very difficult for Alaska to have an individual income tax and the PFD simultaneously, particularly if the income tax payment is higher than the dividend for a significant number of Alaskans. The proposal would face political opposition if a number of Alaskans paid more in income tax than they received in dividends, and it would have more limited revenue-raising horsepower if it was structured to insure that nobody made a larger income tax payment than that year’s dividend.

Additionally, two reasons make it practically difficult to have significant general taxes on individuals, particularly an individual income tax, while simultaneously paying out dividends. One is an administrative argument based on seeming practicality, as Alaskans will ask, “Why are you paying me money while also taxing me?”

The second practical difficulty is based on perceptions of class, regional, and/or ethnic fault lines in Alaska. If there were to be both an individual income tax and a PFD, some people would think they were paying taxes so as to pay dividends to people who don’t pay taxes.

The kinds of calculations described above tend to push Alaska toward having a sales tax instead of an income tax if the PFD remains. In relatively difficult fiscal times in 2002, the Alaska House of Representatives passed a bill that would have imposed an income tax

that tried to mimic the effect of a sales tax and as such was explicitly regressive.<sup>43</sup>

***Guarantee Some Level of PFDs in the State Constitution as a Trade for Using Some Permanent Fund Income in the Budget***

The Permanent Fund principal is protected in the Alaska Constitution, which means that the Permanent Fund principal cannot be spent without a vote of the people of Alaska. The PFD is paid out of the Permanent Fund income, and the Alaska Legislature could as a legal matter end the dividend and spend all the income on regular government operations. Some observers have suggested that when the State of Alaska needs money for regular budget operations the Alaska Legislature should get that money by starting a process to guarantee the dividend in the Alaska Constitution at a level below the baseline set out in current statute in return for explicit public approval to use significant Permanent Fund income in the budget.

The Alaska Legislature has tried a version of this approach before and failed spectacularly, as a proposition with an advisory vote on a plan to use some Permanent Fund income in the budget failed in 1999 by a vote of 83 percent “No.” When and if a proposal to spend Permanent Fund income in the regular budget is brought back as a trade for guaranteeing some level of dividend in the constitution, one political problem is that some voters already incorrectly believe the dividend is protected constitutionally and thus will not want to buy something they already think they own.<sup>44</sup>

***“Cash Out” Part or All of the Permanent Fund Principal as a Trade for Using Permanent Fund Income in the Regular Budget***

In perhaps the most out-of-the-box thinking on Alaska fiscal policy, some have proposed dividing up all or part of the Permanent Fund principal and sending out checks on a onetime basis to all Alaska residents.<sup>45</sup> Under a partial cash-out plan, a portion of the Permanent Fund principal would be distributed in exchange for the income of the remaining principal to be devoted to financing regular government operations.<sup>46</sup> An even bolder proposal would be to distribute the entire Permanent Fund principal, based partly on an argument that when more money is needed for government operations, eliminating the Permanent Fund is the only way to get Alaskans back to a more conventional arrangement where citizens pay taxes to pay for the public services they receive.<sup>47</sup>

Consideration of cashing out all or part of the Permanent Fund principal poses most sharply questions of intergenerational equity. Intergenerational equity tries to be fair between those living in Alaska today and those who will be living in the state in a future period. Some would say intergenerational equity is an odd concept in Alaska, where urban areas have traditionally been heavily transient and future Alaskans are often not the children of current Alaskans. The fact that future generations cannot vote creates a bias toward the interests of the present generations, a problem about which policy makers have sometimes joked, “What has posterity ever done for me?”

A traditional focus on intergenerational equity would tend to suggest that Alaska should invest its resource rents so as to make consumption sustainable and maintain capital intact.<sup>48</sup> This approach is known as “Hartwick’s Rule” in resource economics,<sup>49</sup> and Alaska economist Scott Goldsmith has observed that the State of Alaska is drawing too much from petroleum wealth under the guidelines of that rule.<sup>50</sup>

#### BIG PICTURE CONSIDERATIONS ON THE FUTURE OF ALASKA PUBLIC FINANCES

It is important to recognize political constraints without becoming captive to them. Timing and framing of issues are critical in politics, and the very existence of per capita PFDs shows that sometimes things appear to be impossible until they happen. On the other hand, it does seem like the Alaska Permanent Fund or the PFD would never have been created if its creation was delayed by ten years, as greed would have prevented the establishment of either of the institutions that long after the beginning of the big oil era.<sup>51</sup>

There are four questions that help determine an Alaskan’s views of how to address the coming crunch.

##### *How long do I intend to live in Alaska?*

The timeline of when the State of Alaska’s non-Permanent Fund financial reserves run out is an obviously critical element in when Alaska faces the question of what to do next, but another crucial factor in determining an individual’s preferred solution is his or her personal timeline. For each Alaskan, a critical question is “How long do I intend to live in the state?” If a person intends to leave the state within five years, for instance, that person would probably be less likely to be willing to sacrifice for the long-term good of Alaska, thus limiting the range of fiscal options meriting consideration.

*What do I think the alternatives are?*

It is difficult to get action absent a perceived crisis, as the easiest course is to stick with the status quo if that is seen as a viable option.

*What outcome do I fear the most?*

Experience teaches that fear tends to drive decisions far more than hope, and the intensity of opposition to a particular proposal is likely to be more important than the intensity of support. Some Alaskans are most scared of substantial budget cuts. Some most strongly oppose cuts to PFDs from what they would be under current law. And some are fiercely opposed to general statewide taxes—particularly the individual income tax—to the exclusion of all other considerations. This is where preferences and politics intersect. For example, a person who rank-orders his or her preferences as (1) opposing further budget cuts, (2) opposing cutting the dividend, and (3) reinstating the individual income tax might support cutting the dividend if that person became convinced that such a course was the only way to prevent further budget cuts. When the crunch finally comes, these kinds of calculations might lead to a coalition of two against one. It is likely that those most obsessed with avoiding the income tax will try to scare those most concerned about the budget to combine to try to get Permanent Fund earnings used to fund government operations.

*What is the Permanent Fund for?*

This is one of the most critical questions in Alaska today. This question cannot be answered as a matter of law or history, and each Alaskan should think about it carefully as the State of Alaska faces falling oil revenues and a series of difficult choices.

#### NOTES

1. Discussions with dozens of Alaskans, former Alaskans, and interested observers over the past three decades have sharpened my thinking on the subjects addressed in this chapter. I particularly want to thank Terry Gardiner, Gregg Erickson, Roger Marks, Scott Goldsmith, Eric Wohlforth, John Havelock, George Freeman, Kevin Groh, Theresa Philbrick, Larry Persily, and Allan Shayer, who read and commented on earlier versions of this chapter.
2. Alaska Department of Revenue 2011, Figure 2 (figure refers to State of Alaska's unrestricted revenues for Fiscal Year 2010, which was the period between July 1, 2009 through June 30, 2010); and Goldsmith 2011a, 18.
3. Alaska Department of Revenue 2011, Figure 6.

4. Blanchard 2008; and Alaska Department of Revenue 2011, Figure 9. Although most of the oil flowing through the Pipeline over the three decades of its life came from the Prudhoe Bay field, that is no longer true, as less than half of the oil produced on Alaska's North Slope in recent years has come from that declining supergiant. See Alaska Department of Revenue 2011, Figure 9.
5. Alaska Department of Labor Undateda; Undatedb
6. Alaska Department of Revenue 2010, 2–3.
7. Graphic shown in 2010 dollars, adjusted by the Anchorage Consumer Price index.
8. Goldsmith 2011d.
9. Wohlforth 2010, 19.
10. See, e.g., Stafford 2010. It is difficult to get a precise comparison of Alaska's per capita spending compared to that of other states, both because in Alaska the state government provides much of the money for a number of functions (including education, public safety, corrections, and prosecution), for which local governments are mostly responsible in other states, and because the cost of providing services is so high in rural Alaska. Despite the difficulty of such comparisons, it is generally recognized that per capita state spending in Alaska is significantly higher than that of other states.
11. The concept for this graphic—"the Groh Flow"—comes from the author, and Gregg Erickson has provided the graphic's figures.
12. Hampton and Raimes 2010. The Standard & Poor's ratings firm also raised the state's rating on its general obligation debt to AAA in January of 2012, citing in part Alaska's 'unusually high' budget reserves. (Vekshin 2012).
13. Erickson 2011b That same analysis by Erickson includes a forecast that on June 30, 2012 the State of Alaska's "spendable savings" would grow to \$19 billion.
14. Alaska Office of Management and Budget 2011. The State of Alaska's total annual budget includes federal funds, which provide more than a third of that total state budget.
15. A problem found repeatedly in resource-rich jurisdictions—corruption—led the Alaska Legislature to raise oil tax rates in 2007, the year after raising them for the first time in almost 20 years. Criminal charges brought in 2007 alleged that executives of an oil-services company had bribed legislators in connection with the legislature's consideration of the oil tax bill in 2006, frightening some lawmakers into voting for even higher tax rates in 2007 to avoid "even the appearance of being in the pocket of the petroleum industry." Groh 2011.
16. Alaska Budget Report 2010, 4. "Forecast offers rosy picture, but realities intrude," 2010, 4. In technical terms, the optimistic view is that the decline curve for Alaska North Slope oil production in the future will be more hyperbolic than exponential. *BP Pipelines (Alaska) et al. v. State of Alaska Department of Revenue*, 2010, 126.

17. *BP Pipelines (Alaska) et al. v. State of Alaska Department of Revenue*, 2010, 119–131. Another decision by that same judge issued in December of 2011 that incorporated additional evidence concluded that the Pipeline would operate until at least 2065. *BP Pipelines (Alaska) et al. v. State of Alaska Department of Revenue 2011*, 212. The author has worked on litigation and administrative proceedings regarding property taxes on TAPS as a contract lawyer for a law firm representing the City of Valdez, a municipality that collects property taxes from the owners of TAPS.
18. *BP Pipelines (Alaska) et al. v. State of Alaska Department of Revenue*, 2010, 126.
19. These terms come from Goldsmith 2011b, 1.
20. See *BP Pipelines (Alaska) et al. v. State of Alaska Department of Revenue*, 2010, 120–22.
21. Goldsmith 2011b, 2.
22. Alaska Gasline Development Corporation 2011, 1.
23. Lidji 2011b, 9 and 19; and Lidji 2011a, 10.
24. See Boucher and Persily 2010, 2–3.
25. Marks 2011, 7.
26. Lidji 2011b, 9 and 19; and Lidji 2011a, 10.
27. Lidji 2011b, 9 and 19; Lidji 2011a, 10.
28. Lidji 2011a, 9.
29. Lidji and Cashman 2011, 20.
30. Lidji 2011b, 19.
31. See Lidji 2011b, 9 and 19; Lidji and Cashman 2011, 1, and 20; and Lidji 2011a, 10.
32. Formerly the lieutenant governor, Parnell became governor when the former incumbent Sarah Palin resigned in 2009. Parnell was elected governor in his own right in 2010.
33. The author was the special assistant to the Alaska commissioner of revenue in 1987–1990, which meant that he served essentially as the state’s tax lobbyist. In that position, he successfully advocated for higher tax rates on oil production and unsuccessfully advocated for reinstatement of the individual income tax.
34. Alaska Department of Revenue 2010, 3.
35. Nelson 2011a, 8; and Nelson 2011b, 5.
36. Forgey 2011; Bohrer 2011; and Demer 2012.
37. Office of Governor Sean Parnell 2011; and Cockerham 2011.
38. The State of Alaska had an individual income tax up until 1980. Boucher and Persily 2010, 1. The State of Alaska has never had a general state sales tax, although a number of Alaska municipalities do. Boucher and Persily 2010, 2. The particular nature of rural property ownership in Alaska has produced a general recognition that it would be difficult to levy a statewide general property tax in this 49th state.
39. Although this chapter does not provide a comprehensive discussion of the pros and cons of each of these options, the pursuit of a strategy



- to diversify and expand the Alaska economy through targeted in-state investment of the Permanent Fund principal is both ripe for corruption and a particularly large bet on the government's ability to pick winners in the marketplace.
40. Fiscal Viability for Alaska 2009. The plan is named after the late Roger Cremo, the Anchorage attorney who proposed it.
  41. Inklebarger 2004.
  42. Inklebarger 2004.
  43. Chambers 2002. The bill died in the State Senate. McAllister 2002.
  44. A more bald approach that would not involve a trade is to "cap" the Permanent Fund Dividend to reduce the amount of money distributed each year so that the money not paid out can go into the State of Alaska's regular budget. Straight-out capping of dividends is generally undesirable as a matter of distributional equity, but it makes a difference how capping is imposed. If this "capping" is used, dividends should be capped as a percentage of Permanent Fund income (i.e., by lowering the approximately 50 percent of Permanent Fund income that currently goes to dividends under state statutes) rather than imposing a hard dollar cap on either the size of the dividend or the amount of Permanent Fund income going annually to the dividend.
  45. Along with the question of whether the cash-out should be partial or total, there are variants on how the payout of a cash-out would be structured. The cash-out could be in the form of checks or in the form of shares in a trust based on future receipt of royalties; a royalty trust or beneficial trust would give each individual Alaskan a property right in the receipt of future income. One effect of a trust is that after the establishment of the trust, an Alaskan could leave the state and continue to receive benefits from the trust. The Alaska economic consultant Gregg Erickson explained how a trust could work in a 1997 article in the state's largest newspaper. (Erickson 1997).
  46. McAllister 2001.
  47. Hugh Malone, a key architect of the Permanent Fund as House Finance Committee Chairman and a critical supporter of the per capita Permanent Fund Dividend later in his career as a state legislator, announced some surprising views in an interview shortly before his sudden death in 2001. "I guess I think now that the creation of the Permanent Fund—at least allowing it to grow apparently to unlimited size—may have been a mistake," Malone said. "I don't know what to do with the Fund as it continues to grow and this black beast gets bigger and bigger and is hiding in the closet . . . If I had my druthers, I'd say, 'OK, everybody, line up here and get ready. Here's your last Dividend, because next year we're going to give the Fund away. We're going to give it away to somebody else and it will be their headache after that . . . It's not going to be a part of the Alaska debate or political scene or economic activity anymore. Goodbye.' Because

the risk is too large that it will make people's lives worse instead of better." Rose and Wohlforth 2008, 202–203. The author worked with Malone both when the latter served in the Alaska Legislature and as Alaska commissioner of revenue.

48. See Solow 1986, 144–149.

49. Solow 1986, 144.

50. Goldsmith 2011c, 1–2.

51. Gardiner 2011.

## PART II

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### Wider Application of the Model



Applying the Alaska model  
in a Resource-Poor State:  
The Example of Vermont

*Gary Flomenhoft*

*“The meek shall inherit the Earth, but not its mineral rights”*

*—J. Paul Getty<sup>1</sup>*

Sovereign Wealth Funds (SWFs) are typically found in states or countries with great oil wealth such as Abu Dhabi, Saudi Arabia, Norway, Alberta, and Alaska. The Alaska model might be perceived to apply only to states with oil. Yet SWFs can be based on other valuable resources such as copper (Chile), diamonds (Botswana), or even phosphates (Kiribati). In the United States, the state of New Mexico has three SWFs, the Land Grant Permanent Fund (mineral resources and surface land), Severance Tax Permanent Fund (minerals), and Tobacco Settlement Permanent Fund. Wyoming has a fund from coal, oil, natural gas, oil shale, and other minerals, and Texas has a fund based on royalties and rents from oil, gas, and valuable minerals on public lands.<sup>2</sup> Of the 50 or more SWFs around the world, only Alaska’s pays a small dividend or basic income to residents. The perplexing reasons for this have been further explored by Angela Cummine in chapter 3 of this volume.

One might get the mistaken impression that only oil-rich or resource-rich states can afford such a fund and dividend. Every state or country has substantial untapped revenue available, because many

natural resources and social common assets (discussed below) have been given away by government to private businesses. Businesses then sell them back to the public capturing not only the value they add with their effort, but also the scarcity value or economic rent (discussed below) of the assets given to them by public authorities.

This chapter demonstrates the potential of a basic income from common asset wealth in a state with very little resource wealth at all, the US state of Vermont. Vermont is a small, sparsely populated state of about 620,000 people. It has few valuable natural resources: no fossil fuels, no precious metals, no gemstones, and no minerals except for calcium carbonate (marble), talc, and slate. Although this chapter is specific to Vermont, it shows that other resource-poor states and nations have greater potential for an asset-financed basic income than one might expect. They just have to reclaim sovereignty over their assets that are often given away or stolen. For example, Bolivia is currently capitalizing on its lithium after having 45,000 tons of silver taken from the Cerro Potosi (mountain of silver) by the Spanish Empire. The prior export of most fishing profits out of Bristol Bay in Alaska motivated Governor Jay Hammond to create the Permanent Fund Dividend (PFD) for Alaskans.

The findings presented here are from a study of the value of common asset wealth in Vermont. The author led a team of student researchers who conducted the study at the University of Vermont in 2008. Each part of the study estimates the rental value of one of Vermont's common assets and examines how much of that value is being captured by current taxes and fees. Precise estimates of resource value are not always available. When possible, we consider more conservative and more generous estimates of the rent available. Thus, we could report four figures: a low estimate and a high estimate of the total value of natural resource; and a low estimate and a high estimate of the untaxed portion of the value of natural resources. But trying not to bowl you over with too many numbers, each section reports only two numbers: the low estimate of the untaxed portion and the high estimate of total resource value. This will give readers an idea of the range of possibilities. The smaller figure is more useful for Vermont public policy, and the larger figure is more relevant for other resource-poor areas considering a dividend on the Alaska model.

The study finds (table 6.1) that a conservative estimate of the yearly rental value of Vermont's privately and publicly held common assets is about \$2.01 billion. Of that, about \$790 million is captured by current taxes and fees, mainly the land portion of statewide property taxes. Therefore, about \$1.2 billion of *additional* revenue would

be available in Vermont each year if common assets were rented out instead of given away. That's enough for a \$1,972 dividend for every Vermonter. That is nearly \$8,000 for a family of four—about the same size as Alaska's Permanent Fund Dividend.

Our highest estimate of common asset value of Vermont is \$6.45 billion (28.31 percent of Vermont's GDP). If *all* of that revenue were devoted to a dividend, it could be as large as \$10,348. That is over \$40,000 for a family of four. About 18 percent of the difference between these two estimates is accounted for by the \$790 of resource rent per person that is already being taxed by Vermont. The rest of the difference is accounted for by the conservativeness of the estimates of resource value. Of course, raising the dividend to this level would require the state to find other sources of revenue to support programs currently funded from some of these sources. Subtracting out the already taxed portion of resource revenue from the high estimate would produce a dividend in the neighborhood of \$8,000 per year. But the figure of \$10,348 shows how much economic value each year is attributable to the value of common assets.

This chapter is about *how large* a dividend can be funded by rents on common assets. It is not about *why* rents on common assets should be captured and returned to the people, although section 1A gives a brief justification. Several chapters in this book and its companion volume make such arguments (especially chapters by Widerquist and Howard, Goldsmith, and Carter in Widerquist and Howard 2012; Hartzok, chapter 4, in this volume). Many other books and articles present good arguments for collection of revenue on common assets and for payment of dividends. I refer the reader especially to *Capitalism 3.0* by Peter Barnes, because it inspired this study.

Before section 2 goes through and calculates the rental value of each of Vermont's common assets, section 1 discusses the following background issues: the definition of common assets, economic rent, and public trust resources. Section 3 puts together the financial totals.

## 1. BACKGROUND ISSUES

### A. *What Are Common Assets and How Can They Be Valued?*

Common assets are those things we legally or morally own in common; they are created by nature or by society as a whole. No individual or company produced them, and therefore none can justifiably claim private ownership of them. They include such things as water,

clean air, minerals, public forests, fish and wildlife, broadcast spectrum, land value, the monetary and financial system, Internet, and so on.<sup>3</sup> Many of these are surprisingly valuable assets. Urban land values are often as valuable as oil, as is the broadcast spectrum.<sup>4</sup>

There are many theories and laws that justify public ownership of natural and social assets. Most classical economists, including David Ricardo, Adam Smith, John Stuart Mill, Thomas Paine, and Henry George, said that the earth was a common inheritance, while the products of labor and capital investment should be private. For example, John Stuart Mill said, “The essential principle of property being to assure to all persons what they have produced by their labor and accumulated by their abstinence, this principle cannot apply to what is not the product of labor, the raw material of the earth.”<sup>5</sup>

The Public Trust Doctrine goes back to the Roman Institutes of Justinian, which assured the citizens of Rome that by the law of nature these things are common to all mankind. Forms of common wealth that have historically been protected by Roman law or the Magna Carta include the air, running water, fisheries, forests, the sea, and the shorelines. Laws consequently protected the accompanying common ability to hunt wild animals for food; to gather firewood, building materials, and medicinal herbs; and to graze livestock.<sup>6</sup> This property was called *res communes* (common property) as distinguished from *res publica* (state property) or *res privatae* (private property).<sup>7</sup> The Public Trust Doctrine, as applied through English common law, was incorporated into the common law of the United States, and it provides that public trust lands, waters, and living resources in a state are held by the state in trust for the benefit of all the people.

### ***B. What Is the Theory of Economic Rent?***

Economic rent is the return to an asset over and above the cost of risk, labor, capital, and normal profit. This economic rent is the return to the resource or asset itself, beyond the cost of producing or extracting it, and is the proper source of revenue for a common asset trust fund paying a basic income dividend. Economic rent was originally explained by economist David Ricardo (Ricardian rent) as the excess return to some agricultural land—due to its favorable characteristics such as soil fertility, rainfall, access to markets, and so on—from the same effort compared to the output of less productive land.<sup>8</sup> The term economic rent has been expanded to include all unearned income from ownership of a resource, from a monopoly, from scarcity, or any other reason resulting in unearned excess profits not due to work,



risk, or enterprise. It is also defined as the excess revenue over and above what it takes for a business to bring a product to market.<sup>9</sup>

A simple example of economic rent is the 2008 run-up in oil prices. It has been estimated that oil from the most expensive wells in deep ocean water cost about \$60–80 per barrel to extract including all other costs and normal profit.<sup>10</sup> Easier-to-extract oil costs much less. Gregg Erickson has data from Alaskan oil companies indicating that the average cost of Prudhoe Bay extraction is \$20 per barrel.<sup>11</sup> At the 2008 world price of \$147 per barrel, Alaskan oil companies on average received economic rent of \$127 per barrel, not including royalties or taxes. The most expensive deepwater wells still received \$67–87 in economic rent. Their “windfall profits” are economic rents. In the democratic theory of rent, governments maximize their collection of rent to benefit the public, while in the liberal theory of rent, public resources are made private and rent remains in private hands.<sup>12</sup> This chapter assumes that the democratic theory of rent is applied.

### *C. Legal and Political Issues*

Economic rent on natural and social assets provides a funding mechanism for any state or country to capitalize its assets for an SWF and dividend. Some assets are extremely valuable and could be equivalent to or greater than oil in Alaska on a per capita basis: the broadcast spectrum, financial markets, atmosphere, water, and land value, for example. Laws differ for each resource. The atmosphere has historically been an open-access resource, but this is rapidly changing due to climate change. Land rent in most countries has been retained privately resulting in huge periodic asset bubbles that disrupt economies when they crash. Broadcast spectrum, by law, often belongs to the public (as it does in the United States under the Federal Communication Act of 1934) but has usually been given away by governments in collusion with broadcasters. Surface water has a long tradition of being considered a public trust resource, while groundwater is a public trust resource in some US states. The additional rent that can be captured on common assets, therefore, will vary according to the legal status of the asset.

### *D. Renewable or Nonrenewable?*

Some common assets are renewable and some are not. The only nonrenewable resource used in our Vermont estimate was minerals. It makes sense to create permanent funds from nonrenewable resources

in order to maintain a fund for future generations when the resource runs out. This was the original purpose of the Alaska Permanent Fund. Renewable resources such as the broadcast spectrum or land value could generate rent in perpetuity and it may not be necessary to create a permanent fund. However, one reason to create a fund even from renewable resources would be to provide a revenue stream that is not as subject to the business cycle, and could provide countercyclical, stable revenue when rent declines in an economic slowdown. Distribution of revenue from common assets directly to the public has many advantages, including fairness, efficiency, and freedom. The marginal benefits are greatest to the lowest income people, yet no “Robin Hood” transfer payments are required.

### *E. The Origin of This Study*

In a 2004 course on Green tax revenue, the author proposed the concept of a Common Asset Permanent Fund in Vermont, based on Barnes’s Sky-Trust model.<sup>13</sup> During the Vermont legislative session of 2007, State Senator Hinda Miller introduced a bill embodying the principles of the Alaska model using common asset revenue. The bill was written by legislative counsel Al Boright and was entitled the Vermont Common Assets Trust Fund Bill: S.44.<sup>14</sup> Numerous cosponsors signed on. Although the bill didn’t make it out of committee, concepts from the bill were considered in a groundwater bill and an all-fuels efficiency bill. During a debriefing meeting with David Bollier in September 2007, legislators who worked on S.44 believed they needed more financial details and requested information about potential revenue from common assets. As a response to this request, the study cited here was conducted.<sup>15</sup> The bill was reintroduced in 2011 by Representative Chris Pearson as H.385. In keeping with the Public Trust Doctrine, part of the bill reads:

As society moves into modern times, the list of wealth that should belong to the people in common because the wealth was inherited or created together, and therefore should be preserved in the common interest has expanded now logically to include natural wealth such as undisturbed habitats, entire ecosystems, biological diversity, waste absorption capacity, nutrient cycling, flood control, pollination, raw materials, fresh water replenishment systems, soil formation systems, and the global atmosphere; and also to include socially created wealth such as our legal, political, and monetary systems, universities, libraries, science and technology, the Internet, transportation infrastructure, the radio spectrum, and city parks . . . In the case of public trust

resources, individuals should be limited to uses that do not deplete the capital of the assets, but that are consistent with the commonwealth being available for the enjoyment of future generations.<sup>16</sup>

The following section summarizes the findings of our valuation of common assets in Vermont.

## 2. CALCULATION OF RENT ON NATURAL AND SOCIAL ASSETS

This section explains how we tabulated estimates of the revenue available in Vermont by calculating economic rent on natural and social assets. Without having business cost data it is very difficult to calculate economic rent to any exact degree. Business considers this information proprietary and will be reluctant to divulge the data. Also, they prefer to be taxed on net income, which allows them to deduct all their costs as well as engage in transfer pricing to low-tax countries, allowing them to evade corporate income taxes.<sup>17</sup> These figures are rough estimates for discussion purposes. More exact calculations should be done by revenue departments when putting this system into practice. For some of them it will be impossible to know the exact value in advance. We cannot know how much revenue will be produced by an auction market for carbon emissions or the broadcast spectrum until we hold the auction.

We believe the figures are reasonable, showing the feasibility of the common assets approach. We chose categories according to interests of individual researchers. In the category of natural assets we researched air emissions, fish and wildlife, forests, groundwater, surface water, minerals, broadcast spectrum, and wind turbine potential. In the category of socially created assets we researched land value, the Internet, and the monetary and financial system. We did not include patents, medical research, or other proprietary information because of a limited number of student researchers. This could have added to the revenue estimate, since medical research is mostly government funded. For example, Prozac, Taxol, Capoten, AZT, and Xalatan were all the results of government funding,<sup>18</sup> yet the public receives no royalty payments.

### *A. Natural Assets*

#### *Air (Atmospheric sink)*

The privilege of dumping pollution into the atmosphere as a sink for waste is still free in most places. This is a subsidy to polluters. Carbon

and other greenhouse gasses can be reduced by a carbon tax or by a cap-and-permit system, which establishes fees for the emission of carbon dioxide (CO<sub>2</sub>) into the atmosphere or the introduction of carbon fuels into the economy. Revenue from such policies can contribute to SWFs and dividends anywhere in the world.<sup>19</sup>

There is not yet a clear market for carbon emissions. Therefore, several different sources could be used to estimate the value of carbon costs.

The European Union Environmental Trading System (EUETS) has a mandatory cap-and-trade system in place for power plants and industrial CO<sub>2</sub> emitters. Vermont is currently enrolled in the Northeast Regional Greenhouse Gas Initiative (RGGI), which auctions carbon permits to power plants for their CO<sub>2</sub> emissions. This system only covers about 20 percent of CO<sub>2</sub> emissions in New England. In Vermont revenues are used to finance “all-fuels efficiency,” which pays for weatherization and efficiency programs, rather than a dividend. By expanding the cap-and-auction system to include all sources of CO<sub>2</sub> emissions such as heating and transportation, a substantial increase in revenue could be achieved. Total emissions in Vermont in 2005 were 9.08 metric tons of CO<sub>2</sub> equivalent.<sup>20</sup> Not including power plants, CO<sub>2</sub> emissions in 2005 were 8.44 million metric tons per year. Revenue from power plants in RGGI (\$1.96 million) is already allocated to other uses, so it was not included in our estimate.

Low estimate: using RGGI for revenue. RGGI allocates carbon permits to power plants by quarterly auction. The 2009 permit price of \$3.07 per ton was used for a revenue estimate for CO<sub>2</sub> emissions.<sup>21</sup> Contributing the revenue to a SWF and dividend turns it into a “cap-and-dividend” program.<sup>22</sup> Expanding RGGI to include all emissions at the recent auction price of \$3.07 per ton of carbon and current emissions of 8.44 million metric tons of CO<sub>2</sub>e would generate \$25.9 million additional revenue.

Estimate 2: using British Columbia carbon tax rate. Several years ago the Canadian province of British Columbia (BC) established a carbon tax of Canadian \$10 per ton. “The tax rates as of July 1, 2010 are equal to \$20 per ton of CO<sub>2</sub> equivalent emissions, increasing by \$5 per tonne each year for the next two years to \$30 per tonne in 2012.”<sup>23</sup> Our middle estimate of CO<sub>2</sub> revenue was based on the original BC carbon price of \$10/ton. Canadian and US dollars are currently trading at par, so at the price of \$10/ton it would generate \$84.4 million.

Estimate 3: using EUETS prices. The carbon price on the European EUETS has fluctuated widely. At the time of the report in 2008 the most recent European EUETS price was US\$40/ton. Multiplying by the emissions of 8.44 mmt (million metric tons) would generate \$337.6 million. A carbon tax could also be used, which would generate more predictable revenue.

High estimate. Future carbon prices are uncertain. Many scientists believe that we must reduce our greenhouse gas emissions by 50–80 percent to maintain a livable planet. If that is the case, it may require a carbon price of \$100 or even \$300 per ton. This could result in increasing revenue even as carbon permits are reduced, if demand is inelastic. \$100 per ton would increase the price of gasoline approximately one dollar per gallon, which is equivalent to the increase in US petrol prices from May 2010 to May 2011 due to economic and political forces. The difference is that the revenue would go to the SWF instead of to oil producers. Even \$300/ton or \$3/gallon of gasoline is equivalent to existing gasoline taxes in some European countries, so it is not unreasonable. Applying \$300 per ton to the total 2005 Vermont emissions of 9.08 MMTe would provide \$2.724 Billion.

To be on the conservative side we used our lowest estimate of carbon revenue of \$25.9 million for carbon fees in our report. This would not require saving in a permanent fund, as emission fees will continue as long as fuels are burned, which may be indefinitely. If emissions are ever reduced to zero, then revenue would dry up, and this logic would have to be reevaluated. Any location could use carbon taxes or permit fees to generate revenue for a SWF.<sup>24</sup> The values we have for the tables below are:

Low estimate: \$25.9 million

High estimate: \$2.724 billion

#### *Wildlife and Fish*

Fish and wildlife are among the few resources that have been managed universally as public trust resources, using a cap/permit/fee system. Many governments manage fish and wildlife by selling hunting and fishing permits. A scientific assessment of wildlife reproduction rates is made, and harvesting permits are issued to maintain the resource at a sustainable level. Permit fees are charged to pay for administration of the system and management of the resource, but permit fees are inadequate. Of the \$14.7 million revenue received

by the Vermont Fish and Wildlife Department in fiscal year 2006, student researcher Ross Saxton determined that about \$7.7 million was economic rent and the other approximately \$7 million was the result of taxes.

Hunting, fishing, and trapping licenses generated \$5.4 million in 2006. The Fish and Wildlife Department receives \$621,871 in economic rent from leases on agriculture lands and camps on wildlife management areas, sales of timber, dog licenses, grants from the Vermont Association of Snow Travelers, Vermont All Terrain Vehicle Association, and tuition fees from conservation camps. Federal funds categorized as "other" produce \$363,787 in rent. These are received as grants from organizations such as the National Oceanic and Atmospheric Association. Mandatory boat registration permits produce \$243,617. The sales of conservation license plates produce \$125,986. The income tax checkoff box produces \$99,710. Being donations, this is all unearned income. Duck stamps are similar to hunting licenses, contributing \$16,169 of rent; \$1 million or half the general fund transfer of \$2 million was estimated as rent.

Saxton proposed a biodiversity and land conservation plan based on the number and scarcity of species in a given area based on "critical habitats," and payment of rent proportional to species and habitat scarcity for use of these land areas, a form of scarcity rent. Saxton supported recent efforts to redirect 1/8 of one-cent sales tax from other programs to fish and wildlife, though this is a tax and not rent. He also recommended increasing the capital funding of the existing Fish and Wildlife Trust Fund from \$1.6 million to \$12 million in order to generate more interest income to use as operating funds. The total increase in revenue predicted was \$10.4 million used in our revenue estimate. Since wildlife is managed for sustainable yield, permit fees can be maintained indefinitely. The purpose of the Fish and Wildlife Trust Fund in Vermont is to create an endowment to generate reliable revenue. Adding current taxes of 14.7 million to additional potential revenue of \$10.4 million provides a high estimate of \$25.1 million.

Low estimate: \$10.4 million

High estimate: \$25.1 million

#### *Public Forests*

The public revenue of \$27 million for the year 2008 from forests in Vermont consists of \$3.2 million from state forests, \$6.58 million

from state parks, \$180,486 from fish and wildlife (logging), and \$17 million from “current use” (use value appraisal) program properties. Private revenue totals \$774 million, including \$207.4 million from forest-based manufacturing, \$485 million from recreation/tourism, and \$50 million from paper and pulp. Without knowing other business expenses it is difficult to calculate net profit, so we did not determine what percentage of revenue from these private activities is due to economic rent, and we did not use it in our report. Our estimate was based on the \$32 million from forestry and logging,

Researcher Mark Kolonowski proposed two new sources of revenue: a fee for depletion of ecosystem services by logging, and a higher charge for conversion of current use property to nonforest uses. Since logging removes a fund of trees providing ecosystem services such as CO<sub>2</sub> absorption, climate regulation, reduction of erosion, habitat, and so on, Kolonowski proposes a “Depletion of Ecosystem Services” (DES) fee on forestry and logging. This would be similar to what other states capture in taxes on each board foot of lumber, but would reflect a charge for depletion of the services provided by trees. A charge of 10 percent on just forestry and logging revenues of \$32 million would generate roughly \$3.2 million, which could be used to restore forests, and also feed a trust fund for the public. Another possibility is to revise the penalty when “current use” properties are removed from forestry use and sold for development. This penalty does not seem to adequately recover the revenue lost during the period of current use for forests. In 2007 the current use program resulted in a reduction of \$39.5 million in foregone property taxes, while in 2004 only \$404,155 was collected by the current use change tax. A better formula than the present one would recover all the lost revenue from the sale, by finding the original purchase price of the property, adjusting it for inflation, then subtracting it from the selling price.

Kolonowski also proposed an auction and insurance bond regulation, and the creation of a Vermont forest land bank. Notably, Vermont has a Land and Facilities Trust Fund that could receive new funds. Substantially more than \$3.2 million could be generated by rent on private use of public forests, and additional research in this area is needed. The high estimate adds existing revenue of \$27 million to new revenue of \$3.2 for total of \$30.2 million.

Low estimate: \$3.2 million

High estimate: \$30.2 million

*Groundwater (Underground water taken from wells)*

Privatization of public water supplies (providing tap water for homes and businesses) is a worldwide problem. We did not address that problem here, but researcher Colin McLung<sup>25</sup> focused on water extracted by bottlers for resale. Groundwater in Vermont was put into the public trust in the legislative session of 2008. The latest figures from the Water Resources Division are that seven companies took 32 million gallons of water in 2008 for bottling in Vermont.

In addition, there are at least 16 companies selling bottled water imported into the state. Companies taking groundwater for bottling in Vermont must apply for a permit to operate. They must have a source and EPA permit to check water quality, a construction permit, and an operating permit. But they don't pay any rent to the state for taking the public's water.

For example, a Canadian company called Ice River Springs (also known as Aquafarms) extracts water from wells in Vermont, and then trucks the water to Pittsfield, Massachusetts, for bottling. In Pittsfield, they obtained a tax break to build a \$12 million bottling plant employing 60 people. They get their water from Pristine Springs in Stockbridge, Vermont. So, this out-of-state corporate bottler takes water obtained in Vermont for free and exports it to Massachusetts, where they create jobs in Pittsfield, to benefit owners in Canada. Spring Realty Trust also has withdrawal and selling permits in Vermont and can take water for free and sell it back to us at retail.

According to the website of H<sub>2</sub>O for Maine, an NGO dedicated to creating a "Maine Water Dividend Trust," the gross profit on bottled water is 75 cents on an 85-cent bottle (88 percent profit).<sup>26</sup> This is for a "six pack" of 24-oz. bottles selling for \$3. Bottled water sold in single 32–48-oz. bottles is even more expensive. The cost of water to bottlers is essentially zero. All the costs are in bottling, marketing, and distribution. Eighty-five cents for 24 ounces is equal to \$4.53 per gallon of bottled water. At \$4.53 per gallon, 32 million gallons of bottled water equals \$144.96 million of total revenue. Without knowing other business expenses, it is difficult to calculate the net profit. Consider that Norway charges 50 percent royalties plus 28 percent corporate tax on oil companies drilling in their territory, and still finds companies able to profit from drilling. Using 50 percent royalties results in potential revenue of \$72.48 million for Vermont.

Our original estimate of 34 million gallons extracted in 2008 was based on incomplete information, but it is very close to the latest figure of 32 million gallons. We estimated the cost of bottled water



at \$4.53 per gallon for a total revenue of \$154.2 million. Since the gross profit was estimated to be 88 percent, we used an economic rent figure of 70 percent, resulting in \$107.9 million in possible revenue. This is the figure used in our report.

Another way to estimate the value of bottled water by the gallon is to use the average price of a liter of bottled water at convenience stores: about \$1.79. That converts to a price of \$6.78 per gallon of bottled water. At \$76 per barrel, oil was worth \$1.83 per gallon, and gasoline was \$3–\$3.50 per gallon in the summer of 2011. When we compare unrefined water with unrefined oil we find that water sells for 3 times the price of crude oil and 2 times the price of refined gasoline.

Thirty-two million gallons of water at \$6.78 per gallon equals \$216.96 million in retail sales of bottled water. If the wholesale price were half that, it would be \$108.48 million. Even if we charged a low rent of 12.5 percent—equivalent to typical resource rents on minerals or oil—it would still amount to \$13.56 million in public revenue that could be put toward an SWF. Since unearned income is so much higher on bottled water, we felt a much higher royalty rate was justified. Since water is a renewable resource if used sustainably, the revenue could be distributed annually without being saved in a permanent fund.

In 2011 we conducted additional research and found that total groundwater extraction for various commercial uses in Vermont amounts to 51 million gallons per day.<sup>27</sup> Groundwater extraction above 20,000 gallons per day includes use in golf courses, dairy processing, quarries, irrigation, oven manufacturing, power plant cooling, fish culture, and so on. Countries such as Lithuania, Belarus, Kenya, Fiji, and Brazil charge from 0.18 cents to 30 cents per gallon of groundwater extracted.<sup>28</sup> Brian Kelly and fellow researchers suggested a rate of 0.0000359 to 0.001795 per gallon for all commercial users, the higher rate generating \$13.5 million in annual revenue.

Low estimate unearned profit from bottlers: \$107.9 million

High estimate add fees on all commercial users: \$121.4 million

*Surface Water (Rivers, streams, lakes, and other water flowing above ground)*

According to researcher Elliot Wilkinson-Ray,

First we must acknowledge the fact that water is a Public Trust resource in the state of Vermont. Therefore, the legal property rights for all of

the surface waters in Vermont are granted to the public . . . Although in practice 93 percent (roughly 445 million gallons per day) of surface water withdrawals in Vermont are by private companies without any mandatory compensation for the citizens to which that water belongs.<sup>29</sup>

Current private revenue consists of \$35 million for public supply, \$1.7 million for wastewater permits, \$164.8 million from hydroelectric, \$100 million from thermoelectric, and \$109.1 million for recreation, making a total of \$410.6 million. Water utilities in Vermont currently charge on average \$3 per 1,000 gallons of water just to cover their costs. Wilkinson-Ray contends that “a higher price that included payments towards ecosystem restoration and protection would help curb wasteful water practices.”<sup>30</sup>

Ending the local hydroelectric subsidy would generate \$6 million. Large hydroelectric facilities use 17.5 billion gallons of surface water per day, generating 578.5 megawatts peak. Hydro use of surface water is not considered “withdrawal.” These facilities pay property taxes, but are too small to pay the Electric Energy Tax.<sup>31</sup> Wilkinson-Ray suggests charging 10 percent on use of water for hydro in Vermont, which would generate \$16.5 million. This is purely an estimate and not a rigorous calculation of economic rent, since most of the data is proprietary. Once the initial construction costs are paid for, hydroelectric power has very low operating costs, generating significant economic rent.

The Vermont Yankee Nuclear power plant is the largest single withdrawer of surface water in Vermont, drawing 421 million gallons per day, or 153 billion gallons per year for condenser and reactor cooling. This is 82 percent of the surface water withdrawals in the state. Wilkinson-Ray suggests a charge of 5 cents per 1,000 gallons, or 2 percent of the current wholesale water rate, which would generate \$7.6 million. For the public supply he recommends an increasing base structure, which would add approximately 10 percent of existing public revenue or \$639,000. For other water use he prescribes a fee of 5 cents per 1000 gallons, generating \$438,000. The potential new revenue from water rental payments suggested by Wilkinson-Ray totals \$31.2 million. Water is renewable, so fees could be generated annually in perpetuity, so this need not be saved in a permanent fund. We have only one estimate of new revenue potential.

Estimate: \$31.2 million

### *Minerals*

Researcher Ian Raphael found that unlike Alaska, where the constitution states that the public owns subsurface resources, Vermont requires mining companies to pay only surface property taxes, and nothing to extract the minerals below. The mining industry is still governed by the Mining Act of 1872.<sup>32</sup>

Raphael finds the value of minerals extracted in Vermont to be \$96.8 million annually, not including talc and slate, which are claimed to be proprietary. They do this on land valued at \$132 million, which means that, at the average property tax rate of 2.79 percent, they are paying \$3.7 million in taxes. Adding the property and annual mineral value, Raphael finds that mining companies are only paying 1.6 percent of this total in property taxes.

He also points out that when the minerals are gone, Vermont loses jobs and income, and gets a large clean up bill when all that is left are abandoned mines and environmental waste. Raphael recommends a royalty system of 10 percent on the value of minerals extracted, which is lower than oil royalties of 12–15 percent in Alaska. This might be justified by the extended age of Vermont's mines and possible lower productivity, but this requires more research. Mining companies are not forthcoming with these data. This would generate \$9.7 million for a mineral trust fund. "Vermont needs to reclaim the rights to all its natural resources including minerals... By setting up a permanent fund to offset the extraction of non-renewable mineral resources, Vermont will ensure the prosperity of its amazing heritage and provide a current and future flow of revenue for its citizens."<sup>33</sup> Since current revenue is \$3.7 million, and potential revenue is \$9.7 million, we estimated new revenue of \$6 million. Since minerals are a nonrenewable resource, the funds should theoretically be placed into a permanent fund, but because so few of Vermont's resources are nonrenewable, to keep it simple, I did not assume so for this chapter. We used \$6 million for our low estimate. If a standard royalty rate of, say, 12.5 percent is applied to revenue of \$96.8 million, we get a high figure of \$12.475 million. Adding existing taxes of \$3.7 million provides a high estimate of \$16.175 million, generating the following estimates:

Low estimate: \$6 million

High estimate: \$16.175 million

### *Broadcast Spectrum*

Researcher William Murray tells us that after restructuring in 1994, broadcast frequencies have been allocated by a onetime auctioning

system. Only 2 percent has been auctioned this way, while before restructuring, 98 percent of spectrum was merely given away to private entities for the exchange of “in-kind” public service rather than cash. This is despite the Communications Act of 1934, which states that broadcast spectrum belongs to the public. Currently, 64 percent of the most valuable spectrum below 3.1 GHz is reserved for government use paying no fees. Murray cites a New America Foundation study<sup>34</sup> that calculated the total annual use value of spectrum at \$302 billion, mainly used by broadcast TV, mobile phones, and satellite communications. “Among all else, it is clear that the current mismanagement of socialized radio spectrum allocation provides one of the most promising opportunities for commons reform in the future.” Murray’s calculation of Vermont’s share of spectrum value provides a figure of \$625 million. Using a normal profit of \$250 million, he calculates potential economic rent in Vermont from spectrum at \$375 million. Murray suggests an annual instead of onetime auction, which would provide an ongoing revenue stream from spectrum. “Given all of this information, spectrum policy should be one of the easiest cases to make for common asset reform in the future.”<sup>35</sup> Unfortunately, spectrum is controlled entirely at the federal level by the Federal Communications Commission in the United States, so individual US states may have difficulty collecting rent for use of the airwaves.<sup>36</sup> Sovereign nations may not have this problem. Spectrum is one of the most valuable resources to have been almost completely given away. Since the federal government has jurisdiction over spectrum, we used the national spectrum value prorated by population for the value of spectrum in Vermont, which Murray determined was \$375 million. Again we have only one estimate:

Estimate: \$375 million

### *Wind*

Researcher Susan Skalka<sup>37</sup> introduces the novel idea that wind blowing through the air, captured by wind turbines, like water flowing down a stream captured by hydroelectric dams, is a common asset that could generate revenue for the public. She recommends applying the democratic theory of rent to wind power, where governments would maximize their collection of rent to benefit the public. She recommends that we encourage the nascent wind industry but keep in mind the possibility of monopoly rents in the future, which should be recovered for the public. Skalka discusses the possibility of using a progressive profits tax as a model for how economic rent could be adjusted. If we installed

225MW of wind power generating 10 percent of Vermont's electrical power, wind could generate from \$5.5 to \$172.5 million in economic rent in the future, depending on the price of electricity. We used the conservative figure of \$5.5 million in rent. Since current revenue of \$750,000 is captured by existing wind power taxes, the increase was counted as \$4.7 million. We have the following estimates:

Low estimate: \$4.7 million

High estimate: \$172.5 million

## ***B. Social Common Assets***

### *Land Value*

Researcher Conor Casey argues that while property taxes do collect some economic rent, they fail to collect all of it and also conflate taxes on buildings with taxes on land. Land values are socially created assets, as without population or municipal services land is nearly worthless. Collecting economic rent on land values does not interfere with private property rights to land or security of land tenure. It merely changes who receives the rent. "Decoupling the land and building evaluations from the property tax rate would be a good start towards more effective rent collections."<sup>38</sup> He says that taxes should be economically efficient, eliminating deadweight losses, correcting perverse subsidies, and generally promoting healthy economic growth. This, he argues, is accomplished by increasing taxes on land while reducing or eliminating taxes on buildings. Buildings depreciate, while land generally inflates in value over time, creating economic rent.

Casey points out that median housing prices have increased by 5 percent annually since 1980, although from 2000 to 2007 the figure was 21.72 percent annually (before the 2008 housing bust). Using the long-term 5 percent figure as an estimate of economic rent applied to the statewide land valuation of \$21.4 billion would have yielded \$1.07 billion in land tax revenue for 2007. This would be a 44 percent increase over the actual statewide property tax revenue of \$740.8 million for 2007. Some writers estimate economic rent from land as high as 10 percent of the purchase price of land annually, so our 5 percent figure is conservative.<sup>39</sup> Land values in most jurisdictions worldwide, especially cities, are extremely valuable, but land rent is allowed to accrue to owners. Land taxes are often collected at the municipal level. Vermont is unique in collecting a portion of property taxes at the state level for equalization of education funding statewide. So it has a precedent of collecting statewide land rent.

Casey concludes, “Collecting economic rent from land is a perfectly viable way to fund most, if not all, state obligations.”<sup>40</sup> Since property tax revenue of \$740.8 million is already allocated to the state education fund, we only counted the increase of \$329.8 million in our report. Using a 10 percent land value tax gives a high estimate of \$2,143 million (i.e., including existing tax). Thus, we have the following estimates:

Low estimate: \$329.8 million  
High estimate: \$2,143 million

#### *The Internet and World Wide Web*

The Internet is an interesting case, since it was created entirely with taxpayers’ money by the Defense Advanced Research Project Agency for the US military, while the World Wide Web was created at CERN (a government research laboratory) in Switzerland and placed into the public domain voluntarily in 1993. The Internet and World Wide Web have many features of a commons, and many people refer to the “Internet commons.” Researcher Ida Kubiszewski explored the intricacies of the Internet and World Wide Web to determine if Internet companies are extracting economic rent from the public and how it could be recovered. She finds that companies are making a substantial unearned profit by utilizing a resource that was developed by a collective whole and not through their own efforts. In particular, services of ISPs connecting people to the World Wide Web should be subject to rent as well as the provision of web domain names, because these are areas of Internet and web usage that are generating economic rent for companies. Without detailed cost data, Kubiszewski estimated economic rent in the following way: The average profit for Fortune 1000 companies is 7 percent and everything above that could be considered economic rent.

She found economic rent from public telecoms to be \$17 million, from private ISPs to be \$3.3 million, and from domain names to be \$9.3 million. “Totaling up all the economic rent, we find that economic rent owed to Vermonters is approximately \$30 million per year.”<sup>41</sup> So, here again we have only one estimate for high and low values.

Estimate: \$30 million

#### *Financial System (Speculation)<sup>42</sup>*

Financial markets and regulatory bodies that monitor them are socially created assets that allow financial transactions to take place.

Peter Barnes estimated that 30 percent of the value of publicly traded companies is due to the liquidity of being listed on a stock market for trading.<sup>43</sup> Therefore the public deserves a share of the money generated in these markets. Of all the financial transactions that take place internationally, it is estimated that 95 percent are speculation in paper assets only, and only 5 percent are in actual goods and services.<sup>44</sup> Economist James Tobin suggested a tax (Tobin Tax) to slow down the rate of speculation in currency exchanges, which creates no new goods or services. In February 2000, economist Dean Baker of the Center for Economic and Policy Research calculated the total potential revenue from a 0.25 percent “Tobin” tax in the United States as \$128.4 billion, including revenue from speculation on stocks, government bonds, corporate bonds, futures contracts, currency, swaps, and options.<sup>45</sup> Prorating the total by Vermont’s population (Vermont had 0.21 percent of 2000 US population) would generate \$269 million. Any state or country could do the same. Several countries, including France, Germany, and the United States, are currently considering Financial Speculation taxes.<sup>46</sup> In 2009, Baker revised the calculation to a high estimate of \$353.8 billion, which provides a higher Vermont estimate of \$743 million.<sup>47</sup>

Low estimate: \$269 million

High estimate: \$743 million

#### *Money Creation/Seigniorage*<sup>48</sup>

Banks create 97 percent of the money in the United States through the fractional reserve system,<sup>49</sup> which allows the private banking system and central bank to loan out many times more money than they have on deposit. The monetary system is a socially created system, which has been almost completely privatized by the Federal Reserve Banking System. If we are going to give banks the privilege of seigniorage (money creation), we should at least recover a share of it for the public. In 2004, Vermont banks lent out \$3.57 billion.<sup>50</sup> An arbitrary 1 percent tax on bank money creation would generate \$35.7 million for the common assets fund in Vermont. A better approach would be to establish 100 percent reserve requirements for banks, which would end creation of money by banks.<sup>51</sup>

Money could then be issued by government and loaned or spent. If government is creating credit, there is no reason they could not issue it directly as a basic income instead of loaning it out. As long as government accepts this money back for payment of taxes or other government services, then the money will circulate properly. The other

requirement is to avoid printing more money than available goods and services to avoid inflation. The American colonists were able to achieve it with colonial scrip, and Lincoln did it with greenbacks, so there is no reason we cannot.<sup>52</sup> For now, we used the figure of \$35.7 million in our report, giving us one estimate.

Estimate: \$35.7 million

### 3. PUTTING IT ALL TOGETHER

Potential increased revenue from economic rent on natural and social assets in Vermont was estimated to be about \$1.2 billion (see table 6.1), which equals nearly half of Vermont's 2008 instate revenue of \$2.9 billion.<sup>53</sup> If \$1.2 billion in annual revenue were distributed equally to all 623,050 Vermont residents (2005 estimate),<sup>54</sup> this would amount to \$1,972 per person annually. We used very cautious estimates of revenue, and actual figures could be much higher. For example, using \$100/ton for carbon would generate \$844 million per year in Vermont, equal to three-fourths of our entire estimate just from this one resource.

Using our high estimates for potential revenue, economic rent could generate revenue of \$6.5 billion, which if distributed annually would provide \$10,348 for every resident of Vermont. This would be more than a subsistence income. Other jurisdictions may have much more valuable assets than resource-poor Vermont. For example, some states have billions in mineral or oil wealth, and many urban areas have hundreds of billions in land values or spectrum values. Dumping harmful emissions into the air is a privilege, which will be costly in the future. Every jurisdiction can evaluate these and other sources of economic rent. This exercise is merely an attempt to demonstrate the potential revenue possibilities.

These figures are estimates only, and we do not claim they are precise. But they demonstrate the potential of economic rent.

If we believe that the natural and social assets of every state belong to the citizens of the state, then it is imperative to recapture this value and return it to all citizens rather than leaving it in a few private hands. Every state or country has a collection of common assets that are probably equal to or greater in value than Vermont's common assets. These assets can be used to finance an SWF and dividend along the lines of the Alaska model. If we could do it in poor Vermont, others can certainly do it elsewhere.



**Table 6.1** Low and high estimates of possible dividends for Vermont

<i>Asset</i>	<i>Total current economic rent</i>	<i>Current Vt Tax (in millions of US\$)</i>	<i>Low estimate of new revenue potential (in millions of US\$)*</i>	<i>Explanation</i>	<i>High estimate of total revenue potential (in millions of US\$)*</i>	<i>Explanation</i>
Air	27.9	1.96	25.9	\$3.07/ton CO <sub>2</sub>	2,724.0	\$300/ton CO <sub>2</sub>
Wildlife & Fish	25.1	14.7	10.4	new scarcity rent	25.1	tax 1 new revenue
Public forests	30.2	27	3.2	10% depletion fee	30.2	tax 1 new revenue
Groundwater	107.9	0	107.9	royalty on bottlers	121.4	royalties 1 groundwater fees
Surface water	31.2	0	31.2	user fees	31.2	User fees
Minerals	9.7	3.7	6.0	severance tax	16.2	tax 1 new revenue
Land value	1,070.8	741	329.8	5% land tax	2,143.0	10% land tax
Wind	5.4	0.74	4.7	progressive profit tax	172.5	Potential progressive profits tax
Internet & web	30.0	0	30.0	rent on ISPs and Web domains	30.0	rent estimate
Broadcast spectrum	375.0	0	375.0	user fees	375.0	user fees
Financial system	269.0	0	269.0	.25% speculation tax (Baker 2000)	743.0	2009 Baker study
Monetary system	35.7	0	35.7	1% on 2004 loans	35.7	2004 loans
Total (millions of US\$)	2,017.9	789.1	1,228.8		6,447.3	
Total (in US\$)	\$2,017,900,000	\$789,100,000	\$1,228,800,000		\$6,447,275,000	
Per capital dividend			\$1,972		\$10,348	
2005 VT Population:		623,050				

\* The “low” and “high” estimates differ in two ways: the “low estimate” uses the most conservative estimates of resource values *and* subtracts out the amount already being collected by Vermont tax authorities (\$790 per person per year). The “high estimate” uses more generous estimates of resource values and *does not* subtract out the amount already being collected by Vermont tax authorities.

*Source:* author’s calculations from figures reported above

## NOTES

1. Lenzner 1985, 93.
2. Sovereign Wealth Fund Institute 2011.
3. Tomales Bay Institute 2003, 1–4.
4. Tomales Bay Institute 2003, 15.
5. Mill 1909, Book II, Chap. 2, Sec. 5; Paine 1945, 605.
6. Boright 2007.
7. Tomales Bay Institute 2003, 3.
8. Ricardo 1817, section 2.16.
9. Daly and Farley 2011, 152.
10. Hagans 2011.
11. Erickson 2011a.
12. Warnock 2006, 6 and 27.
13. Barnes 2001.
14. Boright 2007.
15. Flomenhoft and Baer 2008.
16. Boright 2007; reintroduced in 2011 by Chris Pearson as H.385.
17. Warnock 2006, 30–33.
18. Tomales Bay Institute 2003, 21.
19. See Howard, this volume, chapter 10.
20. Vermont Governors Commission on Climate Change 2007.
21. Regional Greenhouse Gas Initiative 2009.
22. Barnes 2001.
23. British Columbia Ministry of Finance 2011.
24. See chapter 10 by Howard in this volume for more details.
25. McClung and Flomenhoft 2008.
26. H<sub>2</sub>O for Maine.
27. Kelly et al. 2011, 2.
28. Kelly et al. 2011, 6.
29. Flomenhoft and Baer 2008, 6.
30. Flomenhoft and Baer 2008, 6.
31. Flomenhoft and Baer 2008, 6.
32. Raphael 2008, 41.
33. Raphael 2008, 43.
34. Snider 2003, 12.
35. Murray 2008, 39.
36. Murray 2008, 36.
37. Skalka 2008, 50.
38. Casey 2008, 48.
39. Dunkel 2007.
40. Casey 2008, 49.
41. Kubiszewski 2008, 34.
42. Flomenhoft 2009, 30.
43. Barnes 2006, 67.
44. Van der Maelen 2005.

45. Baker 2000, 4.
46. Institute for Policy Studies 2010.
47. Baker et al. 2009, 2.
48. Flomenhoft 2009, 30.
49. Brown 2010, 3.
50. Federal Deposit Insurance Corporation 2011.
51. Daly 2010.
52. Brown 2010, 4, 82.
53. Vermont Transparency 2009.
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Alaska's Permanent Fund Dividend as a Model for Reducing Global Poverty

*Paul Segal*

INTRODUCTION

The Alaska Permanent Fund has provided citizens of Alaska with a secure, though variable, source of cash since the first \$1,000 Permanent Fund Dividend check in 1982. While the dividend has never been intended as a poverty reduction measure, such an egalitarian payment cannot help but reduce poverty. It may partly explain the fact that in 2007, before the global crisis, Alaska had the joint second lowest poverty rate of all the states of the United States, despite having only the 19th highest per capita personal income.<sup>1</sup> Drawing on my earlier work,<sup>2</sup> this chapter considers the extent to which a similar model of resource distribution in developing countries could contribute to reducing global poverty.

How best to distribute resource revenues is a perennial question, but it has become particularly important in recent years because of the massive rise in commodity prices that commenced early in the new millennium. Since 2003 these prices, including for hydrocarbons, minerals, and food, have risen precipitously, with the financial crisis of 2008 causing no more than a temporary downward blip. Correspondingly, the revenues received by commodity-exporting nations have also risen. Moreover, combined with improving technologies, rising prices have made previously unprofitable resource stocks into viable commercial propositions, leading to more discoveries and creating new producers in the developing world.

The problem for these producers is to ensure that their resource revenues are well spent, and in particular to avoid the “resource curse,” a malady under which resource-rich countries find that their resources, rather than aiding them on their development path, weaken or corrupt their economies and their political institutions.

In addition to being egalitarian and therefore poverty-reducing, the Alaska model may provide pointers that help to avoid some of the pitfalls associated with the natural resource sector. The scheme I consider here, known variously as a *resource dividend*, a *citizen’s dividend*, or, more generally, *direct distribution*, follows key elements of this model. Most crucially, citizens receive their share of the value of resource revenues as a direct cash payment. I report estimates that imply that if all developing countries were to implement the policy then global poverty would be better than halved.

#### THOMAS PAINE AND THE DISTRIBUTION OF RESOURCE RENTS

While, in a sense the Alaska Fund and Dividend were highly innovative, the idea of giving citizens a direct payment out of revenues due to collectively owned natural resources can be traced back to Thomas Paine’s pamphlet *Agrarian Justice*, published in 1797.<sup>3</sup> Paine noted that the privatization of formerly communal land in England had two important effects. First, productivity had increased substantially because private owners had the incentive to make investments and improvements in production. Second, however, it had taken from the common people the use of a resource over which they had enjoyed rights, and given them no compensation. Paine argued that the private landowners deserved to keep the benefits of their investments, but should be charged a ground rent to cover the free benefit they were receiving from having been awarded the land. Moreover, this ground rent should be used to fund an indemnity payment to those who had lost the use of the land. This would be in the form of a lump sum to every individual at age 21, and an annual pension from age 50.

The first step in this argument is the division of total resource revenues into the part that is due to the skill, effort, or investment of the particular producer, and the part that is not. In modern economic terms the latter component is known as the *resource rents*. These rents are what remain from total resource revenues when all those involved in their production (including the owners of physical capital, human capital, technology, and any other input) have been

paid at the competitive rate. As pointed out by Ricardo, the feature of natural resources that entails the existence of rents is the differential productivity of different stocks of the resource: the market price of the output due to the resource is determined by marginal production, so all production that is more efficient than this marginal case, in the sense of requiring less costly inputs per unit of output, will produce rents for the owner. This applies as much to minerals and hydrocarbons as it does to land.

Thus, in the case of a resource such as oil, if the owner of the resource employs a company to extract the resource for them, then payments to the company count as costs to the owner, and the rents are the owner's net income after those costs have been paid. Then Paine's point can be interpreted as follows. Creating incentives to raise productivity requires paying private owners to invest. But once they have been rewarded appropriately for their investment—which means paying them the going rate on investment, which is just the normal return on their capital—then the remaining income should accrue to the original owners of the land, namely, the common people.

An interesting feature of this argument that is relevant to the Alaska Dividend is that it bypasses the role of the government as the representative of its citizens. In the twentieth century it became a global norm that subsoil resources—though not the land discussed by Paine—are owned by governments, which in most cases lease out rights to resource extraction to private companies.<sup>4</sup> This entails that resource rents accrue (or at least should accrue) to governments, who are expected to use them to benefit their citizens. While in almost all countries this means spending them on public goods, government services, and other government expenditures, the Alaska Dividend is closer to Paine's idea in this respect, giving (a share of) resource rents directly to citizens.

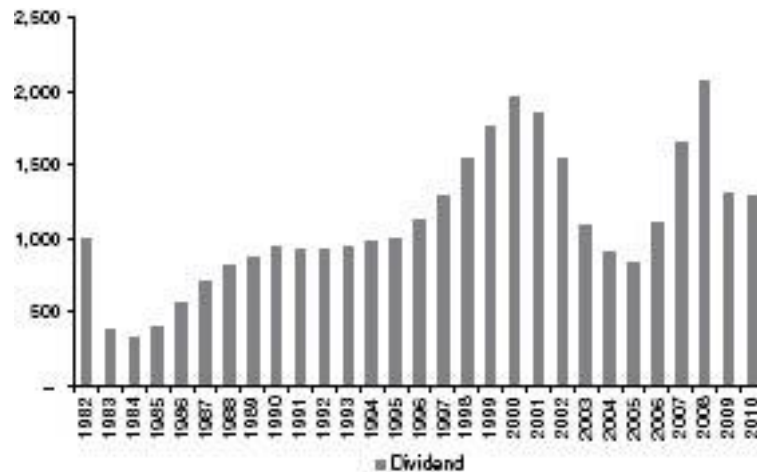
While the Alaska Dividend pays a regular income to all adults, Paine's scheme was a combination of a lump sum payment followed by a regular pension later in life. The closest existing policy to this is Bolivia's non-contributory pension, *Renta Dignidad*, which provides an annual payment of between US\$260 and US\$340 to every individual over age 60.<sup>5</sup> The payment is explicitly described by the government as a means of distributing the rents due to gas and "the concrete result of the nationalization of our natural resources."<sup>6</sup> A further alternative was suggested in the 1970s by the *Financial Times* journalists Samuel Brittan and Barry Riley, who argued that shares in British North Sea oil should be distributed to all British citizens.<sup>7</sup> The most important difference between their proposal and Alaska's

scheme is that Brittan's and Riley's shares would have been tradable on financial markets; the Alaska scheme is closer to a basic income in that the right to the income is inalienable and nontransferable.

### THE ALASKA DIVIDEND AS A MODEL

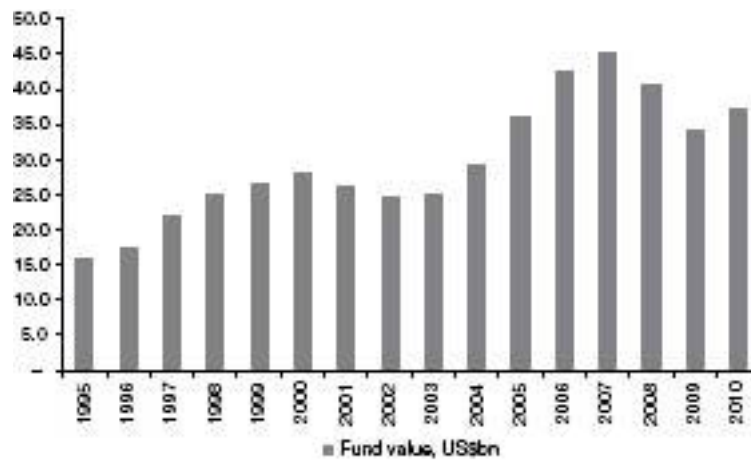
The best-known feature of the Alaska Dividend is the fact that it is a cash payment. But as a means of distributing resource rents to the population, it also has an important intertemporal management role. The Permanent Fund is both a savings fund and a stabilization fund: it both saves revenues for the future and also smoothes expenditures relative to the highly volatile revenues that finance it. By law the fund receives at least 25 percent of the state government's oil royalties. The dividend is then calculated as 52.5 percent of the fund's nominal investment income averaged over five years, divided by the number of eligible recipients, that is, all who have lived in the state for at least one year.<sup>8</sup> In most years the dividend has lain between US\$800 and US\$2,000 (figure 7.1). The stabilization element is implied by the averaging over previous years, implying a smoother time profile of the dividend than if it were proportional to yearly returns.

It is a savings fund because the principal builds up over time, with only (a share of) the investment income being spent. It is therefore a *bird-in-hand* fund:<sup>9</sup> the dividend is the income on revenues already received. Figure 7.2 illustrates the size of the fund and shows



**Figure 7.1** Alaska Permanent Fund Dividend, current US\$





**Figure 7.2** Alaska Permanent Fund, value in current US\$bn

that, though experiencing peaks and troughs, it has been on a rising trend.

Both saving resource revenues and smoothing their expenditures come as standard advice for resource-rich developing countries from economists and international organizations such as the IMF.<sup>10</sup> This is based on both the economic theory of optimal expenditure and the experience of countries that have overestimated their resource revenues and subsequently suffered economic crises.<sup>11</sup> The typical recommendation is to consume the expected *permanent income* from the resource, that is, the expected real return on the expected present discounted value of all future revenues. Put simply, this is the maximum amount of consumption that can be sustained by the resource into perpetuity. Like the bird-in-hand approach, the idea is to invest saved resource revenues in a sovereign wealth fund that will build up over time as revenues continue to flow, and then remain constant in real terms once the resource has been fully extracted.

This approach is less conservative than the bird-in-hand approach because it assumes that future resource revenues can be taken for granted. If resource revenues start off low and are expected to rise over time, then it may even involve borrowing against future revenues in early years. But it is still conservative in the sense that it intends future generations to enjoy as much of the benefits of the resource as present generations. It is therefore consistent with the advice of Barnett and Ossowski who write that “The long-run challenge for

fiscal policy . . . reflecting a concern for intergenerational equity, should be met by targeting a fiscal policy that preserves government wealth—appropriately defined, *inter alia*, to include oil.”<sup>12</sup>

There are, however, reasons for developing countries to be skeptical of this advice. Put simply, if there are significant numbers of very poor people in the present, and if, moreover, economic growth is expected to significantly reduce poverty over time, then it may be most beneficial to spend more resource revenues now in order to reduce poverty. In this case, present generations have greater need than future generations, so intergenerational equity would seem to demand front-loading expenditures, not dividing them equally among generations with unequal needs.<sup>13</sup>

#### THE RESOURCE DIVIDEND

While Alaskans receive a cash payment out of the return to the Permanent Fund, the idea of a more direct payment of resource revenues to citizens, which I refer to as a “resource dividend” (RD), has been gaining in popularity in recent years. The idea is that resource revenues that flow to the government should be given directly to citizens as universal and unconditional payment, rather than going into either a sovereign wealth fund or general government budgets. In this sense it is not quite the same as the Alaska Dividend. However, given the high volatility of such revenues, a smoothing mechanism like the five-year averaging used in Alaska might be desirable, and that would imply the use of some kind of fund in which to keep previous years’ revenues. But the fund would only have to be large enough to support the moving average of resource revenues; it would not have to be large enough that its investment income would supply the dividend.

Such a policy has been proposed for Nigeria by Sala-i-Martin and Subramanian and for Iraq by Palley and Birdsall and Subramanian; Sandbu considers the idea of individual Natural Wealth Accounts for resource-rich countries more generally, which could be used to pay cash dividends to citizens.<sup>14</sup> These authors have argued that the individual right to an equal share of natural resource revenues will help to avoid the institutional aspects of the “resource curse,” or the finding that natural resources may lead to corruption and low government accountability. Natural resources give governments an easy source of revenue that, according to this argument, enables them to ignore the needs of citizens. Governments that have to raise revenue by taxing citizens, on the other hand, are more dependent on the goodwill of those citizens, and therefore have to be more accountable to them.<sup>15</sup>

While the proposition that natural resources weaken institutions has been undermined by more recent research,<sup>16</sup> there remains a strong argument that individual rights to resource revenues will increase transparency and lower the probability of corrupt individuals stealing those revenues. This is supported by studies of “leakage” of government revenues more generally in the developing countries, where leakage is the loss of resources that are budgeted by the central government to provide public services. In many cases, what is reported on the central government budget is not what reaches the intended beneficiaries, with resources getting lost along the way to corruption and inefficiency. One conclusion of these studies is that cash benefits to individuals are more likely to find their target than benefits in kind.<sup>17</sup> This is largely because it is easy to inform people exactly how much cash they should receive, and they are more likely to make a fuss if it does not arrive.

This advantage of cash payments extends the argument beyond resource-rich countries, and my earlier work considers the idea of a RD in all developing countries that have any natural resource revenues.<sup>18</sup> Using World Bank data on income distributions in developing countries, and on resource rents in those countries, we ask the question: what would happen to global poverty if every developing country implemented the RD? The calculations use the World Bank’s PPP\$1.25-a-day poverty line at 2005 prices (at purchasing power parity), or PPP\$38 per month, and estimate poverty reduction using resource rents in each of the years 2000 to 2006, and the three five-year averages 2000–2004, 2001–2005, and 2002–2006. The latter averages are intended to allow for smoothing along the lines of the Alaska Dividend—although, again, the payment is direct from resource rents, rather than the income from a fund.

The estimation consists of the following steps. For each country we first divide estimated resource rents among all citizens to establish the value of the RD. Thus, in the case of India over 2002–2006 resource rents comprise 4.9 percent of GDP and the dividend is worth US\$2.9 per person per month. This is then translated into PPP\$, that is, multiplied by the purchasing power of international currency in the country. This is important: in 2005 one US dollar would have bought 44 Indian rupees on the currency markets. But in urban India 44 rupees would have bought about US\$2.5-worth of goods and services, while in rural India it would have bought about US\$3.8-worth. For this reason the US\$2.9 per person per month translates in real terms into PPP\$7.3 in urban India and PPP\$11.1 in rural India, which comprise, respectively, 19 percent and 29 percent of the poverty line.

So for the 342 million people living below that poverty line in rural India in 2005, the RD would increase their income by at least 29 percent (more for those further below the poverty line).

However, since in many cases governments will already be taxing natural resources, we must take account of the fact that the lost revenue may have to be made up for. Governments may reduce expenditures, in which case this will compromise poverty reduction to the extent that government services serve the poor. Or they may compensate by raising other taxes, in which case any of these new taxes that fall on the poor will similarly compromise poverty reduction. Here we assume the latter case, and we assume that the tax rise is proportional to income—though it may be due to any combination of value added tax, income tax, reductions in subsidies, and other revenue-raising fiscal policies. In India where resource rents averaged 4.9 percent of GDP, after adding the dividend we then subtracted 4.9 percent from every individual's income to account for increased tax payments. This assumption facilitates the estimation, but since the very poor often pay no tax, in practice, this calculation can also be interpreted as a lower bound on the amount of poverty reduction.

The estimated impact on global poverty in different years, applying the above calculation to every developing country, is reported in table 7.1. Details of selected large countries are presented in table 7.2.

Consider the five large countries Brazil, China, India, Pakistan, and South Africa, all of which have resource rents below 6 percent of GDP. These five countries account for 54 percent of the total

**Table 7.1** Global poverty estimates with RD and RD less tax, and reduction relative to current poverty

	<i>With RD, less tax</i>		
<i>Year of rents</i>	<i>Number (millions)</i>	<i>Share %</i>	<i>Poverty reduction %</i>
2000	969	18.7	27
2001	922	17.8	31
2002	948	18.3	29
2003	927	17.9	30
2004	739	14.3	44
2005	723	13.9	46
2006	582	11.2	56
2000–04	883	17.0	33
2001–05	811	15.6	39
2002–06	729	14.1	45

Source: Segal 2011a.

**Table 7.2** Estimates for selected large countries, 2002–2006 rents

				<i>Poverty headcount PPP \$1.25 a day (PPP \$38 a month)</i>					
2002–06		<i>Resource Dividend (monthly), 2005 prices</i>		<i>Current</i>		<i>RD, with taxes</i>		<i>Gini</i>	
<i>Country</i>	<i>Rents % of GDP</i>	<i>PPP\$</i>	<i>US\$</i>	<i>Number, million</i>	<i>Share %</i>	<i>Number, million</i>	<i>Share %</i>	<i>Current</i>	<i>With RD<sup>b</sup></i>
Brazil	4.6	\$27.1	\$17.5	14.5	7.8	0.0	0.0	55.4	50.4
China	5.2	rural: \$19.6 <sup>a</sup>	\$7.2	211.9	16.2	24.4	1.9	41.7	35.2
		urban: \$14.3 <sup>a</sup>							
India	4.9	rural: \$11.1	\$2.9	455.4	41.6	247.8	22.6	34.9	29.8
		urban: \$7.3							
Indonesia	11.4	rural: \$32.3 <sup>a</sup>	\$11.6	47.3	21.5	1.3	0.6	36.2	26.2
		urban: \$22.9 <sup>a</sup>							
Iran	40.1	\$285.3	\$86.4	1	1.4	0	0.0	38.4	15.7
Mexico	7.8	\$73	\$51.2	0.6	0.6	0	0.0	48.1	39.4
Nigeria	51	\$49.4	\$29.6	91.1	64.4	69.0	48.8	42.9	19.1
Pakistan	5.3	\$9	\$3.1	35.2	22.6	16.5	10.6	31.2	27.4
Philippines	1.3	\$3.1	\$1.4	18.8	22.6	16.3	19.6	44.0	42.7
Russia	33.9	\$283.8	\$134	0.3	0.2	0	0.0	37.6	19.3
Thailand	4.2	\$19.3	\$8.4	0.3	0.4	0	0.0	42.5	38.6
Turkey	0.4	\$2.7	\$2	1.9	2.7	1.7	2.3	43.3	42.8
Vietnam	13.9	\$18.6	\$7	17.8	21.4	4.2	5.1	37.8	30.8

*Note:* <sup>a</sup> Rural and urban PPP\$ values for the RD differ because of price differences. Prices are generally lower in rural areas, so the real value of a given cash RD is higher.

*Source:* Segal 2011a.

GDP. These five countries account for 54 percent of the total

population of all developing countries and 74 percent of the poverty reduction due to the RD. The dramatic poverty reduction estimated is therefore not primarily due to resource-rich countries, indicating that even modest levels of resource wealth can have a dramatic impact on poverty if distributed universally.

These direct estimates, using data on both resource rents and on within-country distributions, go up to only 2006. But rents are driven by commodity prices, for which we have more recent data, and over the years 2000–2006 the estimates for poverty reduction have a correlation coefficient with commodity prices of 0.95. These prices bounced back robustly after a dip in 2008–2009 and at the time of writing in late 2011, and despite fears of further economic stagnation and falls in markets and commodity prices in the summer of 2011, most commodity prices remain higher than in 2006. Using a simple regression to estimate a relationship between the two, based on the 2000–2006 estimates, it is found that global poverty would have been better than halved every year since 2006.<sup>19</sup>

Is this method of poverty reduction sustainable? Natural resources are by their nature exhaustible, but while individual deposits get used up, continuing exploration often leads to rising production and reserves. Proven reserves of oil, for example, have risen every year but one over 1980–2010.<sup>20</sup>

Moreover, as long as resource prices stay high we can expect more dramatic results in the future from increased discoveries in poor countries that have so far received little foreign investment in resource exploration. Uganda, for instance, has discovered oil and expects to be earning US\$2bn a year from 2015.<sup>21</sup> With a population estimated at 41.0 million in that year,<sup>22</sup> this amount translates into a RD of PPP\$11.7 per month.<sup>23</sup> According to the World Bank, 37.7 percent of the population were below the PPP\$38 poverty line in 2009;<sup>24</sup> with an extra income of PPP\$11.7 per month, that percentage drops by half, to 18.9 percent.<sup>25</sup> If those shares were to remain constant until 2015, it would translate into raising 7.7 million people above the poverty line, and will be raising the incomes of those who remain below the poverty line by at least 44 percent.<sup>26</sup>

#### BEHAVIORAL RESPONSES

A standard argument against unconditional payments such as the RD is that they may reduce the incentive to work. Economic theory predicts that if people are given a lump sum as extra income then they will use some of the income to “buy” more leisure, that is, work less,

if they have the option to do so. This argument applies more strongly the poorer is the recipient: the larger the benefit relative to existing income, the larger the predicted effect on labor supply.<sup>27</sup>

There are two main counters to this argument. First, it is a partial equilibrium argument in the sense that it considers the direct effect of the extra income, holding all other things constant, and ignores the indirect effects that it may have. For instance, most poor people are credit-constrained and therefore are unable to borrow in order to make investments that would increase their earning power. The most obvious such investment is in schooling: poor families often do not send their children to school because they need the income that they can earn through working, even if in the long run they would be better-off making the investment in human capital. A payment like the RD will provide cash that enables such investments. Equally, credit-constrained farmers may be unable to buy fertilizers despite their high return. In this case payments that loosen credit constraints can lead to a rise in productivity and, hence, economic growth.

In practice, existing cash transfers, such as those found in Mexico, Ecuador, and Cambodia, are found to have little effect on labor supply, though a negative impact on labor supply was found in a study of Nicaragua.<sup>28</sup> In Bolivia, on the other hand, in households of recipients of the unconditional pension *Bonosol*, the precursor to the present *Renta Dignidad*, consumption in recipient households was found to increase by twice the amount of the benefit, suggesting that it enabled them to increase production.<sup>29</sup>

The second main response to the fear that the RD might reduce labor supply is that if some people do indeed work less when given the benefit, it will be because working less is better for them. Since the behavioral change is entirely voluntary, it presumably reflects an increase in well-being: they work less because they prefer to spend the time doing something else. Moreover, while they may be enjoying more leisure, they may equally be doing other productive activities that, nonetheless, do not pay, such as housework or care work. If it is really the well-being of the poor we care about, then we should not object if they choose to spend extra income on working less.

#### POVERTY REDUCTION AND TARGETED BENEFITS

Another possible objection to a universal and unconditional payment like the RD is that it is inefficient as a tool for poverty reduction because the nonpoor receive as much as the poor. The first argument against this objection is that part of the motivation for the RD is the

fact that all citizens have an equal right to their resource rents. Its poverty-reducing effects are a further argument, but not the driving principle behind it. As a result, its universality is likely to inform public support for the policy, and it is likely to be much less popular if it is aimed at only a subset of citizens.

This point is formally analyzed by Gelbach and Pritchett with a model of the government budget where the executive chooses a universal or a targeted scheme, subject to majority voting.<sup>30</sup> Under plausible assumptions, they show that a majority will vote for a universal scheme that gives everyone, including the poor, an amount larger than the largest feasible targeted scheme. That is, so little will be assigned to any politically supported targeted scheme that the poor are better-off under the politically feasible universal scheme. Empirically, Cornia and Stewart find that “mostly, it seems that the switch [from general to targeted subsidies] also leads to reduced real value of the subsidy over time (as in Zambia, Sri Lanka). Less strong political support for the targeted schemes probably accounts for this.”<sup>31</sup>

Cornia and Stewart, on the basis of nine case studies, also observe that targeted schemes such as food stamps often miss large shares of the target population. Similarly, Soares et al. find that Brazil’s targeted benefit *Bolsa Familia* reaches only 41 percent of the poor, while Mexico’s *Oportunidades* reaches only 30 percent.<sup>32</sup> The additional step of establishing that an individual is indeed part of the target population creates both a barrier that can deter the intended recipients and the possibility that whoever is doing the monitoring will make a mistake and wrongly exclude someone. Moreover, establishing citizenship is much easier than establishing income levels or other conditionalities, implying that a universal payment is much easier to implement.

## CONCLUSION

The Alaska Dividend is fundamentally a tool for distributing the benefits due to natural resources to the population, and it is unusual in two respects: it is a cash payment; and it is universal and unconditional. It is not quite a direct payment of resource revenues because the dividend is paid out of the return to Alaska’s Permanent Fund, which is itself financed by oil revenues. This chapter considered a more direct version of the payment of resource revenues to citizens, referred to as the *resource dividend*, and its use in developing countries.

This form of redistribution is justified by the nature of resource rents, but it also has other benefits, including the potential to reduce corruption and ameliorate the resource curse. Most importantly,



it has the potential to dramatically reduce global poverty. As we approach 2015, the focus of the Millennium Development Goals, many countries are not on target to achieve the first goal of halving the proportion of people living below PPP\$1.25 a day from its 1990 level.<sup>33</sup> While these countries are poor, this chapter showed that even relatively modest levels of resource wealth can have a large impact on poverty when distributed to all citizens.

#### NOTES

1. Segal 2011a.
2. Segal 2011a.
3. Paine 2007 [1797].
4. The United States is the only major country in which subsoil resources on private land belong to the landowner.
5. See Segal 2011b for details.
6. Bolivian Ministry of Autonomy 2008.
7. Brittan and Riley 1978.
8. Alaska Permanent Fund Corporation 2011.
9. For discussion of different kinds of optimal expenditure patterns, see van der Ploeg and Venables 2011.
10. E.g., Barnett and Ossowski 2003.
11. See Adam and Simpasa 2009 on Zambia's use of its copper revenue.
12. Barnett and Ossowski 2003, 47.
13. Segal 2011b.
14. Sala-i-Martin and Subramanian 2003; Palley 2003; Birdsall and Subramanian 2004; Sandbu 2006.
15. Karl 1997 gives the most detailed version of this argument, based largely on a study of Venezuela.
16. Haber and Menaldo 2011.
17. Gauthier 2006.
18. Segal 2011a.
19. Segal 2011a.
20. BP 2011.
21. Economist 2010.
22. IMF World Economic Outlook online database.
23. 2005 prices, using PPPs from World Bank 2008.
24. PovcalNet: the online tool for poverty measurement developed by the Development Research Group of the World Bank, <http://iresearch.worldbank.org/PovcalNet/povcalNet.html>.
25. I use PovcalNet with the poverty line  $\text{PPP}\$38 - \text{PPP}\$11.7 = \text{PPP}\$26.7$ . Since these are new revenues, I do not need to subtract an additional compensating tax.
26. To remain below the poverty line despite receiving the dividend, income would have to have been below  $\text{PPP}\$38 - \text{PPP}\$11.7 = \text{PPP}\$26.7$ , and the dividend is 44 percent of  $\text{PPP}\$26.7$ .

27. This is because a higher income implies a higher opportunity cost of not working, and hence a higher marginal cost of leisure. So a given benefit will buy less leisure.
28. Fiszbein et al. 2009, 117 – 120.
29. Martinez 2012, cited in Barrientos 2011.
30. Gelbach and Pritchett 2002.
31. Cornia and Stewart 1993, 437.
32. Soares et al. 2007.
33. United Nations 2010.

Constituting the Commons: Oil and Development in Postindependence  
South Sudan

*Jason Hickel*

South Sudan became the world's newest nation on July 9, 2011, to a great deal of fanfare from the international community that had followed its devastating civil war for more than a generation. Some 2.5 million Sudanese were killed during the course of this conflict, a number that demonstrates how desperate Khartoum was to maintain control over the southern territory. A primary reason for this desperation was oil: South Sudan holds between 75 percent and 85 percent of the untapped petroleum reserves in the greater Sudanese region, and around 75 percent of the 500,000 barrels of oil presently extracted each day comes from the South. The Comprehensive Peace Agreement that ended the war in 2005 required that the export revenues from oil in the South be split evenly between the two regions, which has translated into more than \$10 billion for each side over the past five years. With little other economic output to speak of, South Sudan's share of this revenue accounts for 71 percent of its GDP and a whopping 98 percent of the government's annual operating budget.

I visited Juba, the capital of South Sudan, in 2010 with a team of other Alaskans to share our state's unique model of oil revenue management with government policy makers there. We traveled at the invitation of the Southern Sudan Youth Forum for Referendum—an organization of young leaders, most of whom were educated abroad, who are deeply concerned about the economic future of their region in the postindependence era. Many of the people we spoke to, including

Vice President Riek Machar, expressed hope that independence and the renegotiation of the wealth-sharing agreement would give the Government of South Sudan (GOSS) greater control over the petroleum reserves within its borders. Expectations are high across the country that, with total control over oil revenues, the government will be able to ameliorate poverty and lift the country out of its intractable state of underdevelopment. The severity of the situation can hardly be overstated: with a poverty incidence of 90 percent, literacy rates as low as 24 percent, and life expectancy at a mere 42 years,<sup>1</sup> South Sudan has emerged into the dawn of national independence only to find itself at the very bottom of global development rankings.

Having achieved independence, the new government—headed by President Salva Kiir—is now faced with a difficult set of policy choices regarding petroleum management that will shape the future trajectory of the country in powerful ways. It is crucial that the government makes the correct decisions early on, before entrenched interests set in and make progressive change difficult to achieve. This chapter offers a few policy options that will help South Sudan avoid the “resource curse” (explained below) and transmute oil wealth into meaningful, sustainable development. I draw specifically on the experiences of the US state of Alaska, which uses an innovative model that combines a sovereign wealth fund and direct distribution of dividends, rooted in the concept of “the commons”—the notion that Alaska’s resource wealth belongs by right to all Alaskans. I examine the prospect of implementing the Alaska model in South Sudan and suggest certain changes and additions to the model that would make it appropriate for the country’s particular needs. While I agree with the editors of this book that direct distribution of oil revenues holds a great deal of progressive policy potential, I argue that South Sudan should use this strategy as only a small part of a broader revenue management framework.

#### THE RESOURCE CURSE

Historically speaking, South Sudan’s hopes for generating development from oil revenues are terribly misplaced, for the exploitation of oil in Africa has rarely brought about positive socioeconomic outcomes. Indeed, quite the opposite is true: regions with an abundance of nonrenewable subsurface resources nearly always experience declining development and slower economic growth than countries with fewer such resources.<sup>2</sup> Nigeria offers a disturbing example of this trend. Since production began in the mid 1960s, Nigeria has

seen an oil bonanza worth more than \$340 billion. But, despite this massive infusion of wealth, the economy remains in absolute tatters: more than 70 percent of Nigerians live in conditions of absolute poverty—earning less than a dollar a day—and the infant mortality rate is among the highest in the world. In fact, poverty levels in Nigeria today are more than double what they were at the start of the oil boom. Average incomes in 2000 were less than one-third of what they were in 1980, and GDP per capita (adjusted for inflation) remained at about 1965 levels despite ballooning petroleum revenues.<sup>3</sup> Similar problems plague Africa’s other major petroleum producers, such as Chad, Angola, Gabon, and Equatorial Guinea.<sup>4</sup>

Economists call this paradox of poverty amid plenty the “resource curse.” As economies become overreliant on extractive industries, exchange rates appreciate and make imports cheap to the point of undercutting local producers—a scenario known as the “Dutch Disease.”<sup>5</sup> This makes economic diversification impossible, and, once the resource is depleted, the country in question will have little economic infrastructure to fall back on. Furthermore, given the extreme volatility in their prices, overreliance on revenues from natural resources makes government planning for much-needed development objectives exceedingly difficult, as budget flows can change suddenly and dramatically. In addition, when states rely on rents instead of taxes for the bulk of their revenue, the social contract between government and citizens gradually erodes; citizens have no incentive to hold administrators accountable, and administrators have no incentive to invest in human resources, encourage industry, or promote the development of a middle class that would provide a sustainable tax base.<sup>6</sup> Such “rentier states” tend to become authoritarian and heavily repressive, funneling oil revenues into military forces in order to maintain their grip on power and keep citizens in check. Oil-producing countries spend three times more on military force than developed countries and ten times more than underdeveloped countries, as a proportion of GDP.<sup>7</sup> And, to make matters worse, the likelihood of conflict increases to 22 percent when resource exports constitute 33 percent of a country’s GDP, compared to 1 percent for countries with no such exports.<sup>8</sup>

If careful controls are not put in place soon, South Sudan may suffer exactly this fate. Instead of producing positive development outcomes, petroleum exploitation is likely to deepen income inequalities, entrench poverty, degrade the economy, and devastate the environment. Most importantly, the country’s small-scale farming sector—the main source of livelihood for around 60 percent of

the population—could collapse as a result of the impending influx of foreign currency, leaving vast swathes of people even more vulnerable to poverty than they already are.

#### IMPLEMENTING THE ALASKA MODEL

Carefully targeted legislation could not only prevent the resource curse in South Sudan, it could successfully leverage oil wealth for poverty alleviation and sustainable development. Alaska provides an excellent example of how this can be done. Upon achieving statehood, Alaskan leaders drafted a constitution that includes a unique article that deals specifically with natural resources, mandating that they be developed “on the sustained yield principle” and “for the maximum benefit of the people,” in order to protect nonrenewable resources from corporate exploitation and government misuse. In addition, almost immediately after oil was discovered in the 1970s, the state established a “Permanent Fund” (comparable to Norway’s Future Generations Fund and other sovereign wealth funds) designed to provide a sustainable source of investment revenue that will last until long after the oil is gone. The Permanent Fund presently totals \$40 billion, having grown from an initial investment of \$734,000 in 1977.

Since 1982, a portion of the earnings from the Permanent Fund has been distributed directly to Alaska residents in the form of a personal check, known as the Permanent Fund Dividend (PFD). As the editors point out in the introductory chapter to their earlier book,<sup>9</sup> the purpose of the PFD is twofold: first, to ensure that every Alaskan benefits directly from the exploitation of resources that are considered to be owned in common; and second, to supply every Alaskan with a partial basic income guarantee designed to stimulate local economies and help remediate poverty and social inequality. Over the past decade the PFD has averaged around \$1,500 per person per year, and it accounts for an average of 6 percent of annual income per household—a proportion high enough that households come to rely on this income for their yearly budgets.<sup>10</sup>

In addition to these benefits, economists Todd Moss and Lauren Young have argued that the PFD has been instrumental in helping Alaska forestall the resource curse—to which it would otherwise be extremely vulnerable given that the state relies on petroleum for over 80 percent of its revenue—by generating a powerful social contract between citizens and the state.<sup>11</sup> They assert that the direct distribution of oil revenues “was designed explicitly to manufacture citizen

oversight” over the oil industry, and has produced “an influential constituency with an interest in responsible resource management and the means to hold government accountable.”<sup>12</sup> Since residents rely on the PFD to supplement their livelihoods, they tend to vote in a manner that supports careful and responsible resource management.<sup>13</sup> No politician can get away with mismanaging revenues or siphoning the Permanent Fund for special interests without voters immediately recognizing foul play and responding accordingly.

This strategy could be usefully implemented in South Sudan, which is beginning its existence with an absolute absence of social contract and no history of democratic accountability: the most direct predictors of the resource curse. This puts the state in an extremely precarious position, for, according to Moss and Young, policy intervention to avoid the resource curse has only worked “in countries where there is not only a mechanism for holding government actors accountable, but also a politically powerful group that has a strong interest in continued sound management.”<sup>14</sup> In other words, no progressive policy measures (such as those presently being promoted in Juba by Oxfam, the International Monetary Fund, the World Bank, and Norway’s Oil for Development program) will succeed in forestalling the resource curse unless this fundamental problem is dealt with first.

This approach could also help transform the way South Sudanese think about common resources. Until now, Sudan’s model of resource management has been extremely exploitative. For one, oil companies enjoy total tax exemption, meaning that they get to take the country’s crude oil for free (though they give part of it back to the government in accordance with “production sharing agreements”). In addition, they are allowed to use water as liberally as they like (the oil industry is extremely water-intensive), depleting the aquifers on which surrounding communities rely for subsistence. Finally, and most drastically, they have been given tacit permission to forcibly displace the residents of oil concession lands by burning or bombing villages in order to ensure that their operations remain undisturbed. Companies such as China’s CNPC<sup>15</sup> have either supplied their own private mercenaries for this task or requested military assistance from Khartoum.<sup>16</sup> In sum, following the basest dictates of neoliberal policy, the government has essentially given away the commons—oil, water, and land—for multinational corporations to exploit at will, without any return to the citizens to whom those commons belong.

Direct distribution of resource revenues in South Sudan may provide a solution to these problems by creating a constituency that will demand responsible resource management and by creating a sense of

ownership over resource wealth—in other words, by constituting a concept of the commons. South Sudan's reserves are presently estimated at 5 billion barrels. Assuming today's rates of extraction (137 million barrels per year), these reserves can be expected to last about 36 years.<sup>17</sup> Because production rates will fluctuate over time, it is difficult to predict how much revenue this will generate on an annual basis. But given current projections at today's prices, the prevailing structure of production sharing agreements (by which the government claims around 70 percent of oil produced), and assuming the end of the 50/50 sharing deal,<sup>18</sup> South Sudan can expect as much as \$4 billion (in absolute dollars) per year in oil export revenues in the near term. All of the figures represented in this chapter have been calculated in absolute dollars. I cannot accurately calculate Purchasing Power Parity (PPP) because no reliable figures exist yet for South Sudan, but we can assume that dollars will have a great deal more purchasing power there than they do in the United States. The figure of \$4 billion represents a windfall of \$2 billion per year over the original \$2 billion per year that was allocated to South Sudan before independence. Over the past five years, the entirety of the original amount has gone directly into the state budget. This practice will need to continue until other sectors of the economy begin to generate revenue. I will offer suggestions for how to manage that original revenue in a later section. For now, I will focus on how to manage the windfall revenue.

I recommend that 25 percent of total annual petroleum revenues—calculated over a four-year average to smooth out price fluctuations—should go into an Alaska-style Permanent Fund to provide a sustainable investment base for the post-petroleum era.<sup>19</sup> That would amount to a \$1 billion investment each year. At this rate of savings, after 36 years the principal could be around \$60 billion, assuming an interest rate of about 4 percent. Then, I would suggest that 15 percent of total revenues should be distributed as direct cash payments to individual citizens (only adults, in order to avoid incentivizing higher birth rates). Given a population of about 4.2 million adults,<sup>20</sup> an annual disbursement of \$600 million would translate into about \$145 per adult per year or around 25 percent of average household income.<sup>21</sup> Not only would this provide well above the proportion of average income that has created such an interested constituency in Alaska, it would also stimulate local economies (particularly rural ones) and provide a partial basic income guarantee that would dramatically reduce poverty by ensuring a baseline level of welfare. At some point, as the economy diversifies and costs of living increase,



the size of the personal dividend could be augmented with some or all of the interest from the Permanent Fund.

To further improve the social contract and promote the development of a responsive and accountable government, I recommend that an additional \$400 million of the oil revenues be added to the direct dividend, so that the total payout can be taxed as personal income at the rate of 40 percent. Circulating revenues in this manner would increase income tax receipts from their present level of 1 percent to over 17 percent of the existing \$2.3 billion budget while still ensuring that each adult keeps \$145 per year in direct distribution after taxes. The goal should be to eventually get tax receipts to constitute about 20 percent of the total budget, which is the proportion that economists consider necessary in order to avoid the rentier trap. This would force GOSS to justify its taxes by using them to provide responsive public services such as health care, education, and so on, thereby harnessing oil revenues to create and fortify a robust social contract.<sup>22</sup>

Direct distribution will only work if it is implemented in a manner that protects against fraud and effectively reaches all citizens. This could prove difficult in South Sudan, where the population is rural, far-flung, and largely illiterate, and the banking infrastructure is not well-developed for personal transactions. One way of getting around these limitations would be to distribute cash payments through the mobile phone network and the airtime vendors that operate out of most rural outposts, a practice rapidly gaining currency in other parts of the continent. Another method might be to distribute cash through existing institutions that people visit on a regular basis, such as public schools; indeed, linking regular cash disbursements to children's school attendance might generate the much-needed auxiliary effect of improving educational outcomes—a crucial precondition for an effective social contract. To protect against fraud in the process of distribution, the state could use a system of biometric IDs (as Ghana has done), which would mitigate the problem of illiteracy, facilitate other personal financial transactions, and perhaps even streamline voting procedures.

#### POTENTIAL PITFALLS OF DIRECT DISTRIBUTION

The idea of direct distribution has its critics, to be sure, even among longtime Alaskans. The most frequent objections usually hinge on the fact that the money from the PFD does not circulate through the local economy; much of it ends up getting used on vacations

abroad, on shopping trips to Seattle, on cars and other imports, and to pay for out-of-state college tuition. In South Sudan, however, any amount of direct distribution would be too small for this to become a serious problem, and recipients (being mostly impoverished) would almost certainly spend it on local commodities such as food. Rather, the concern is that spending too much on direct distribution would mean channeling money toward elementary consumption rather than toward the infrastructural and social development necessary for the economy to succeed and diversify in its early stages of consolidation.

In his last book, *Crisis of the Commons: The Alaska Solution*, former Alaska governor Walter Hickel spelled out his opposition to the personal dividend and argued instead for what he called a “community dividend,” by which earnings from the Permanent Fund would be distributed to each resident’s local government and be set aside for priority development sectors such as schools, ports, hospitals, and so on.<sup>23</sup> This approach received enthusiastic support from the Alaska Municipal League, representing the state’s mayors and city councilors, who continue to lobby for it to this day. But most voters rejected the idea, having come, by that time, to expect the supplementary income that the PFD provides. Juneau politicians also resisted the concept of the community dividend on the grounds that it would reduce the power of the budget earmarks that get them reelected by local constituents grateful for the pork they bring home.

Governor Hickel’s objections to the PFD illustrate a concern that many progressive scholars have regarding the concept of the basic income guarantee in general, namely, that while appearing to participate in the logic of social welfare, it often inadvertently draws on and reproduces some of the most problematic tenets of neoliberal ideology. The debate over a proposed basic income guarantee (BIG) in South Africa illustrates this paradox nicely.<sup>24</sup> The initial proposal was for direct payment of about \$16 per person per month, to be paid to all South Africans regardless of their social position. As anthropologist James Ferguson has pointed out, the justifications for this measure drew on traditional welfare-state arguments, including “themes of social solidarity and moral obligation; the advantages of social cohesion and the dangers of class war; Keynesian arguments about stimulating demand; and labor-rights arguments about giving workers the security to say no to dangerous and demeaning work.”<sup>25</sup>

Ironically enough, however, many policy makers in South Africa use the logic of BIG to leverage a utopia of small states and untrammelled markets, recasting the idea of social spending as “investment in human capital.” Instead of advocating for social safety nets and a

robust welfare infrastructure, supporters of the BIG<sup>26</sup> want to decentralize social assistance—bypassing the “nanny state”—by giving cash directly to individuals with the expectation that they will rationally invest it in private forms of nutrition, education, housing, and health care in a manner that will make them more productive. In addition, BIG advocates believe that existing social safety nets breed dependency and disincentivize productivity among poor people; they hold that the BIG, by contrast, will encourage poor individuals to act as entrepreneurs, take risks, generate profitable returns, become self-reliant, and ideally produce “development” from below. As Ferguson puts it, in this discourse “the poor individual is explicitly conceptualized as a microenterprise”;<sup>27</sup> providing basic income security for all becomes a method for producing neoliberal subjects. This lines up with Foucauldian analyses that read neoliberalism as a form of government that operates via market “freedom” rather than state control.<sup>28</sup>

There are, of course, many compelling reasons to promote the basic income guarantee from a progressive standpoint. For one, such guarantees validate the agency of the poor and get around the moralizing nature of welfare bureaucracies, which tend to police conduct and determine eligibility by applying the stigmatizing label of “disability.” Also, under the current welfare system in South Africa many poor households do not receive state support because they are not “lucky” enough to have grant-eligible children, elderly, or disabled members. The BIG concept, by contrast, would prevent such households from falling through the cracks. Furthermore, it bears pointing out that the BIG proposal resonates with recent demands from labor unions—including COSATU (Congress of South African Trade Unions)—as well as calls from “autonomists” of the academic left who radically question state power. Hardt and Negri, to cite the most famous example of the latter, have called for “a social wage and a guaranteed income for all” that does not depend on Fordist-style formal employment with its associated exclusions of gender, race, and age.<sup>29</sup> For them, this demand is central to popular progressive politics in a post-Fordist economic context of “biopolitical production” and “immaterial labor.”

Still, the problem with the BIG system is that it does not, in and of itself, protect citizens against the hazards and failures of the market. Indeed, in the libertarian version promoted by conservative thinkers such as Charles Murray, the BIG is supposed to shift the responsibility for providing social protections from the state to private individuals—a move that bears clear connections to the neoliberal ideology of, say,

Friedman, Thatcher, and Reagan. Another problem is that the BIG concept abandons the idea—central to social democracy—that the state should ensure that all citizens have access to formal employment as a fundamental right. As Ferguson has put it, instead of correcting for employment deficits and helping people acquire full-time jobs, the BIG vision of social assistance “reconfigures the condition of unemployment not as a hazard, but as the normal condition.”<sup>30</sup> In this discourse, the informal sector is not a problem to be overcome but an opportunity to be enhanced, expanded, and incorporated. In South Africa, for instance, BIG advocates celebrate the informal sector as a space of creativity, flexibility, and dynamic growth, and they seek to leverage unemployment as a generator of micro-entrepreneurial productivity instead of battling it as a symptom of structural violence.<sup>31</sup>

Along with the contributors to this book, I support the progressive possibilities of the basic income guarantee. But I would caution against using a BIG in place of other forms of government intervention in the context of South Sudan, whose economy is decidedly not post-Fordist in the manner that Hardt and Negri assume. Some scholars concerned about the resource curse in Africa—such as Moss and Young<sup>32</sup>—want to see 100 percent of oil revenues disbursed through direct distribution in order to maximize the social contract. By contrast, I would argue that a basic income guarantee should be implemented along with conventional social-democratic policies, which should be funded with a proportion of oil revenues.

This approach would prevent a number of calamitous outcomes. For one, a rapid injection of cash into a context of extreme poverty could radically inflate the cost of food and water, and encourage the formation of monopolies around basic resources. Second, too much cash circulating through a society in a state of war would inevitably fund arms purchases, and encourage military factions to hijack people’s income grants for their war chests. Third, without concerted focus on infrastructural development—particularly surrounding the oil industry—the state could find itself overly dependent on foreign investment and forced to cede control of its resources to multinational corporations. Finally, too much direct distribution would constitute an unsustainable use of nonrenewable resources and leave the state without an economy at the end of the oil era.

#### IMPROVING ON THE ALASKA MODEL

There are a number of measures that the GOSS could implement to tailor the Alaska model to the country’s particular needs. To begin

with, in order to prevent government corruption, all of the oil revenues that the state receives should go immediately into an independently audited escrow account rather than into the state treasury, with audits available to the public on a quarterly basis. After allocations to the Permanent Fund and the personal dividend, 5 percent of total revenues should go to the local governments of the oil-producing regions, to be used in part to compensate people who are negatively affected by the industry's operations and to augment their basic income guarantee. This strategy has recently been adopted in Nigeria to a great deal of international acclaim.

The remaining 35 percent of total revenues—or \$1.4 billion—should go back to the GOSS budget, and it should be reserved for “priority sectors” such as education, health, and infrastructure in a manner that approximates Governor Hickel’s concept of the “community dividend.” These funds should be allocated according to a democratic oversight committee composed of representatives from civil society, trade unions, and the government in order to fortify against misuse. One immediate objective should be to follow the example of Cuba by eliminating illiteracy within two or three years.

Ten percent of revenues should be designated specifically for economic diversification and to fund import substitution and infant-industry protection.<sup>33</sup> Using oil money to subsidize more sustainable sectors such as manufacturing and small-scale agriculture would prevent the Dutch Disease, create widespread local employment (which the oil industry does not), and wean the state away from its dependence on rents to rely instead on taxes paid by a growing middle class. This would help fortify a social contract and provide the basis for a viable economy in the post-petroleum era. The remaining 10 percent should be freed up for discretionary spending. Ideally, these allocation ratios should be enshrined in the constitution in order to prevent executive changes (see table 8.1).

**Table 8.1** Summary of proposed petroleum export revenue allocations

Permanent fund	25%	\$1,000 million
Direct distribution	15%	\$600 million
Compensation	5%	\$200 million
Priority sectors	35%	\$1,400 million
Diversification	10%	\$400 million
Discretionary spending	10%	\$400 million
Total	100%	\$4,000 million

Some of these principles have been experimentally applied in other countries. Sao Tome and Principe recently passed the “Oil Revenue Management Law”—designed with the help of economists from Columbia University—to establish a Future Generations Fund and channel oil revenues for development and poverty reduction. By using oil revenues for economic diversification, Indonesia has raised its manufacturing sector from 1.2 percent of total exports to 54.4 percent.<sup>34</sup> In 1998, Chad passed “Law 001”—under an agreement with the World Bank—which established an independently audited escrow account for oil revenues, created an oversight committee, and reserved oil revenues for specific priority sectors. Unfortunately, Law 001 failed not long after it was implemented: legal loopholes, vague definitions, and an underequipped monitoring staff allowed the state to dissolve the development fund and siphon oil wealth for other purposes.<sup>35</sup> With a nuanced understanding of Chad’s failures in mind, South Sudan could design legislation that would prevent a similar fate. One step might be to use language from Alaska’s constitution to require that natural resources be used for “the maximum benefit of the people” and only according to principles of sustainability. Such provisions would arm citizens with powerful leverage to ensure that the country’s common wealth benefits all.

In addition to these measures, South Sudan could improve the cost-benefit ratio of extraction in a number of ways. On the regulatory side: (1) Local content rules should require that all foreign investors in the oil industry tier up over a set period to at least 80 percent local contracts and labor, and should require investment in local capacity where it proves too poor to meet the necessary standards by developing infrastructure and training/educating local workers. (2) All workers should have access to union representation (to prevent casualization and other forms of exploitation), and should be paid at least a living wage, calculated by region according to the costs of basic necessities. (3) Environmental regulations on extractive industries should be raised to meet the highest international standards; both foreign and national oil companies should pay into an escrow account to cover the costs of future spills, and all pollution and environmental damage should be heavily taxed, with the proceeds returned to everyone as part of the personal dividend.

On the revenue side: (1) Following Norway, the government could retain an Ethics Adviser for the proposed Permanent Fund in order to ensure that its investments meet conscientious environmental and labor standards and promote local growth wherever possible. (2) The government should charge concession royalties and tax oil company profits at more than the shocking 0 percent rate that is presently in

effect, beginning with Norway's 78 percent tax and adjusting downward to account for underdeveloped infrastructure and geopolitical risk to investors. This resource tax should be thought of as a fee for the private use of common resources. Bolivia used this approach to revise its tax code on extractive industries and managed to raise its oil revenues from \$448 million in 2004 to \$1.53 billion in 2006.<sup>36</sup> (3) The state should enhance transparency frameworks by implementing strong Freedom of Information laws, disclosing all public contracts and promoting active public monitoring of the fund account and budgeting process.

Of course, in order for South Sudan to reap the benefits of oil production, the country must actually receive the revenues that are owed to it in the first place. A new study by Global Financial Integrity shows that commercial tax evasion and commodity mispricing accounts for up to 65 percent of illicit capital flight from Africa, compared to only 3 percent through domestic corruption.<sup>37</sup> Since 1970—the beginning of the era of neoliberal market deregulation—as much as \$1.17 trillion has disappeared from the continent through tax evasion and mispricing alone. This trend is most conspicuous in the case of petroleum-exporting countries where foreign multinationals have a strong presence, with Nigeria and Angola topping the list. In Sudan, about \$11 billion disappeared between 1970 and 2004. Implementing the Extractive Industries Transparency Initiative (EITI++)<sup>38</sup> would be a good first step toward solving this problem, as it requires regular publication and independent audit of all financial exchanges between oil companies and governments. But the EITI cannot prevent mispricing, and it also cannot expose the common practice whereby companies launder money internally in order to report lower taxable profits. To plug these holes, South Sudan would have to solicit the services of dedicated international watchdogs such as the Tax Justice Network.<sup>39</sup>

#### ON “DEVELOPMENT”

This approach to resource commons rejects the neoliberal consensus that poor countries should compete to attract foreign direct investment by eliminating tax codes, eviscerating regulatory mechanisms, and giving resources and pollution rights to corporations for free. Economic history demonstrates that plunder on this order never advances the development of poor countries in any meaningful way. The proposals I have outlined above suggest an alternative model of development that helps resolve this contradiction by instating solid democratic controls over resource commons. This creates a way for poor countries to extricate themselves from exploitative economic

relationships with rich countries and multinational corporations by asserting greater control over the processes and profits of extraction and by funneling resource wealth inward rather than allowing it to be siphoned outward.<sup>40</sup> As the Alaskan experience has made clear, there can be no legitimate excuse for high poverty rates with this sort of system in place.

But in the case of nonrenewable resources such as oil, even the most carefully regulated forms of extraction are not ideal. Indeed, South Sudan's oil-based economy represents something of a Faustian bargain: they will gain a little bit of quick oil wealth, yes, but only in exchange for adding 1.8 billion tons of carbon dioxide to the atmosphere and causing widespread ecological damage. To put this in perspective, it bears pointing out that the country's entire petroleum endowment will satisfy global demand for less than 60 days—a mere two months—at current rates of consumption. There is something fundamentally irrational and myopic about this bargain, especially given that, bordering the Sahara desert, South Sudan is disproportionately vulnerable to the risks associated with climate change.<sup>41</sup> Rapid desertification has already forced mass migrations in the west of the country over the past few decades, which has led to starvation, violence, and considerable social upheaval.<sup>42</sup>

Now is the time to begin seeking meaningful alternatives to fossil fuels and extractive capitalism, rather than perpetuating the status quo. Ideally, the ultimate goal of the petroleum revenue structure that I have suggested above should be to eventually phase out the petroleum industry altogether, transmuting oil wealth as quickly as possible into the basis of a more sustainable and environmentally friendly economy. Alternatively, another option that South Sudan should consider is to follow the example of Ecuador's Yasuni-ITT<sup>43</sup> initiative, whereby Ecuador promises to keep its oil in the soil and thereby protect its rainforests in exchange for 50 percent of the income—in the form of donations from around the world—that the state will forgo as a result. South Sudan could accomplish this by trading on the high levels of global sympathy attached to its status as the world's newest—and poorest—country. Given the costs associated with the resource curse and climate change, this option would work out to be significantly better for the country's economy.

## CONCLUSION

South Sudan's recent political independence marks a momentous occasion, but it will ultimately amount to very little if the nation follows



Nigeria, Angola, and other petroleum-exporting African states and succumb to the resource curse. True independence for the people of South Sudan depends on informed, democratic management of the nation's common natural resources toward carefully formulated, collectively ratified goals. Franz Fanon, one of Africa's greatest voices in the national independence movement, captured this sentiment nicely when he noted that "for a colonized people the most essential value, because the most concrete, is first and foremost the land: the land which will bring them bread and, above all, dignity."<sup>44</sup> In the context of European colonialism, Fanon understood the importance of the commons for guaranteeing the well-being of the people.

This chapter has offered some concrete proposals for what Fanon's vision might look like in the case of South Sudan, extending the idea of the commons to encompass not only the land but also all other natural resources, the environment, and human labor. I have argued that South Sudan should follow the Alaska model by investing its petroleum revenue windfall in a Permanent Fund that will establish a basis for economic security in the long term, and by distributing a portion of revenues in the form of direct dividends to all adults on the basis that every citizen has an equal right to the nation's resource endowment. Direct distribution of \$145 per person per year would not only provide a partial basic income guarantee that would rapidly cut poverty rates but would also help manufacture a solid social contract and build a broad constituency that will keep the state accountable. This figure could be significantly augmented over time with revenues gained by eliminating mispricing, with interest from the Permanent Fund, with higher resource tax rates, and with revenues from taxes on pollution and other forms of damage to the environment. Recovering revenue currently lost to mispricing could add \$35 to the annual dividend that I have proposed.

I should pause here to point out that the numbers and proportions I have suggested above are exactly that— suggestions. It would be entirely possible, for example, to make the dividend larger by shifting revenues from priority sectors. The numbers I have chosen reflect an attempt to balance a relatively small revenue windfall (given the size of the population) among the competing concerns that extremely underdeveloped economies like South Sudan have to address. I should also point out that the proportion of revenues earmarked for the dividend does not have to remain constant; it may be advisable to begin with larger dividends to boost people out of desperate poverty, and then gradually wind down in order to focus on economic diversification and development priorities.

The editors of this book have argued that by implementing the dividend concept and a partial basic income guarantee, communities can assert ownership of the commons and prevent companies from thinking that they are free to take—and dump waste into—things that appear to be unowned, such as subsurface minerals, forests, water, fisheries, and the atmosphere. As collective owners of the commons, communities should demand compensation for the use and exploitation of their environment as a basic cost of doing business. If this policy is to be put in place in South Sudan, it must happen very soon. During my visit to Juba in 2010, a number of political leaders confided in me that the government was overwhelmed with oil industry lobbyists—mostly from China—and Western organizations such as USAID jockeying for influence over concession redistribution and petroleum-related legislation, which has not yet been drafted. If South Sudan does not act decisively in defense of the commons now, it may never be able to change course.

#### NOTES

1. According to the New Sudan Centre for Statistics and Evaluation 2004.
2. Auty 1993; Sachs and Warner 1995; Gelb 1988; Collier and Hoeffler 2000.
3. Gaille 2011; Meredith 2005.
4. Ghazvinian 2008.
5. The Dutch Disease was first theorized by Corden and Neary 1982.
6. Karl 1997; Ross 2001.
7. Itriago 2009.
8. Collier and Hoeffler 2000.
9. Widerquist and Howard 2012a.
10. Goldsmith 2002b.
11. Moss and Young 2009. See Moore 1966 for a treatment of the “social contract” concept.
12. Moss and Young 2009, 1.
13. See Goldsmith 2002b.
14. Moss and Young 2009, 8.
15. China National Petroleum Corporation.
16. Fatal Transactions 2008.
17. These figures will change significantly over time, of course, as (a) additional reserves are discovered; (b) production rates improve as the region returns to a politically stable state; and (c) production rates then gradually decline in the long term as the available oil becomes increasingly difficult to extract. It is important to note that South Sudan’s oil production environment is changing very very quickly.

- Since oil came on line in 1999, speculation and production figures have fluctuated a great deal. The figures I use in this chapter are contemporary estimates, but it could look quite different in as little as five years.
18. Many of South Sudan's leaders have argued for the outright abolition of the sharing deal, but more realistic analysts suggest that something on the order of a 20/80 or 30/70 North/South sharing deal would be more reasonable, given that the South will probably need to rely on the North's infrastructure in the near term. Given this uncertainty, the revenue figures that I use here should be treated as estimates.
  19. The 2005 Comprehensive Peace Agreement provided for payments of an unspecified amount into a Future Generation's Fund, but only once production levels reach 2 million barrels per day.
  20. These figures follow the results of the 2008 census. Adults (above 17 years of age) constitute about half the total population of 8.3 million. Some analysts suggest that this number may reach as high as 9 million.
  21. No data exists for average incomes in South Sudan. For the sake of simplicity, I'm assuming \$365 per person per year, on average, given that the New Sudan Centre for Statistics and Evaluation indicates that 90 percent of the population lives on less than \$1/day. The 10 percent figure, then, is a very low-end estimate; it could reach as high as 50 percent or more in the case of impoverished rural families.
  22. See Ross 2004.
  23. Chapter 10 in Hickel 2002.
  24. Department of Social Development 2002.
  25. Ferguson 2007, 80.
  26. See Tilton 2005; De Soto 2000.
  27. Ferguson 2007, 80.
  28. Rose 1999 and Cruikshank 1999; both cited in Ferguson 2007.
  29. Hardt and Negri 2000.
  30. Ferguson 2007, 82.
  31. See Bourdieu 1998 on the structural violence of unemployment.
  32. For example, Moss and Young 2009.
  33. Following Chang 2003.
  34. Itriago 2009.
  35. See Chapter 6 in Ghazvinian 2008 for an explanation of why Chad's Law 001 failed.
  36. Itriago 2009
  37. Kar and Cartwright-Smith 2010.
  38. The EITI++ requires transparency not only for receipts but for licensing (backwards) and expenditures (forwards) as well.
  39. Tax Justice Network 2006.
  40. This notion builds on the insights of dependency theorists such as Rodney 1974; Wallerstein 1989; Frank 1967; and Isbister 2006.

41. Ideally, developed countries should shoulder the burden of the shift to a nonfossil-fuel-based economy, and allow poor countries a longer transition period so that they do not remain stuck in poverty as the price of environmental sustainability. The World Bank estimates that the cost of climate change to Africa and India—as a proportion of GDP—is about 4 to 5 times greater than that to the world as a whole, as their agricultural sectors are significantly more vulnerable. The Climate Justice Movement refers to this imbalance as “ecological debt,” and calls for reparations to be paid to developing countries for the adverse effects of climate change.
42. Mamdani 2009 discusses how desertification has contributed to the long-standing conflict in Darfur.
43. Ishpingo-Tambococha-Tiputini.
44. Fanon 2004, 9.

The Ideal Solution: A Plan for Iraq?

*Jay Hammond*

INTRODUCTION: JAY STERNER HAMMOND—EGALITARIAN PHILOSOPHER,  
ALASKA GOVERNOR

*Larry Smith*

Alaska was the great initial beneficiary of Jay Hammond's thought and work. He consistently combined policy initiatives concerning ecology and the economy, citing the Greek word *oekos* as the root for both words.

Ecology—the environment—properly cared for, would provide a permanent fund of wild renewable resources with a harvestable dividend: the sustained yield, as required by Article 8, Section 4, of the Alaska Constitution, of “fish, forests, wildlife, grasslands, and all other replenishable resources” to provide necessities of life.

Economic activity, properly managed, could provide a permanent fund to contribute cash dividends in the same manner.

Jay Hammond proposed, but was unable to widely implement, cooperative ecosystem management, which would permit economic development compatible with adequate protection of wildlife, citing salmon and caribou as prime examples of creatures that migrate through Native and other private lands as well as adjacent state and federal areas managed for multiple purposes. Cooperative management, “co-mans” in his phrase, would better provide dividends of both sorts.

He went to work hammering out the instruments of good state government when Alaska became a state in 1959. Creative proposals for “Bristol Bay, Inc.” (his home ground) and “Alaska, Inc.” did not come to fruition, but eventually, when he was state governor from 1974 to 1982, these ideas merged with the flow of petrodollars into the Permanent Fund and its dividend program. Although all fell well short of his ambition to save more, the dividend program, nevertheless, provides Alaskans with greater equity.

Jay Hammond was clear thinking and prophetic to a remarkable degree. His ideas for achieving the maximum benefit for the people were original and well-informed. In his final work, *Diapering the Devil*, he sought to bring the ideas that benefited Alaskans to the people of Iraq and around the world.

Editor’s note: This is an excerpt from Jay Hammond’s last book, *Diapering The Devil: How Alaska Helped Staunch Befouling by Mismanaged Oil Wealth; A Lesson for Other Oil Rich Nations*. Homer, Alaska: Kachemak Resource Institute, 2011. The book was released after the author’s death. This section appears here with minimal editing.

In the spring of 2003, a *New York Times* article by Steven C. Clemons<sup>1</sup> advocated a Permanent Fund dividend-type program for Iraq, asserting nothing could do more to promote a democratic capitalistic mind-set among masses of unemployed young Muslims. Were they to sample a bit better life while here, they might be less inclined to seek “paradise” by blowing themselves up along with as many “infidels” as possible.

Every revolution in history—including Russian, Chinese, French and US—was triggered by the gulf between the “haves” and “have nots.” Certainly Iraq seems fertile ground for another. Under Saddam, those at the top lived in opulence and those at the bottom in squalor. Oil wealth fattened the few, while the many starved. Shunting some of that wealth to the latter might do a lot to help forestall further chaos. Certainly, it would incline most Iraqis to oppose terrorists who were blowing up “their” pipelines and thereby hitting each and every Iraqi directly in the pocketbook.

I sent the *Times* article to Senator Ted Stevens, suggesting he show it to President George W. Bush. Stevens advised he had, and that the president was intrigued. Soon after, Secretary of State Colin Powell and members of Congress were on television advocating dividends as an Iraqi democratization effort.

Later, I was asked to keynote an address to an international congregation in Washington, DC, supporting such a plan. Brazilian Senator Eduardo Suplicy introduced me saying: “A few years ago, I read this man’s book outlining Alaska’s dividend program [*Tales Of Alaska’s Bush Rat Governor*]<sup>2</sup>. It inspired me to introduce legislation in Brazil. Last year the Governor signed it into law. Brazilians feel it’s one of the best things that ever happened.”

Economists, educators, and others present then stated what they thought to be a dividend plan’s potentials, not only for Iraq but also for their own countries. At conference’s end, dividend programs had been proposed for Mexico, Chad, Venezuela, Ecuador, and Bolivia, among others.

Doctor Stephen Bezruchka of the University of Washington School of Medicine made an intriguing presentation.<sup>3</sup> He had studied the general health of various nationalities. To his surprise, he found the health of a nation was not nearly so dependant upon quality or availability of health care as on the gap between the “haves” and the “have nots.”

He cited Japan, which (despite having the highest rate of smoking among developed countries) now ranks number one in the world so far as collective health of its citizens is concerned. Japan once ranked 16th while the United States ranked 13th. What caused the change?

According to Dr. Bezruchka, the United States has the greatest wealth and income gap of any rich country, which is the main explanation for its dismal health ranking among developed countries. We did not always fare so poorly. In 1960 we were 13th. As our wealth and income gaps have grown, so has our distance from being the healthiest country. After the Second World War, Japan restructured its economy to be egalitarian. Today, during its economic crisis, managers and chief executive officers are taking cuts in pay rather than laying off workers, something that is inconceivable in the United States.

By contrast, America has continued to drop on that international “health meter” and by 1997 had dropped to #25. Dr. Bezruchka attributes this to the fact that for the past 20 years every state has seen an *increase* in the gap between the “haves” and “have nots,” with one exception. Alaska is the only state in which that gap has narrowed.

His attributing this to dividends at first confused me. After all, both fat and not so fat cats get the same dollop of dividend “milk.” Why, therefore, would the gap not remain constant? The answer, of course, is now we have almost 200,000 new income recipients, children, added to the equation, boosting those at the lower end.

During my comments to the conference, I mentioned that I had urged US Senator Ted Stevens to advocate an Iraqi dividend program to the president, and I hoped to discuss it with the president personally. Not all conferees were Bush supporters. One complained: “Hey, that might help get Bush reelected. How about getting together with Kerry instead?” Another asked, “If we can arrange it, would you meet with Nader?” My response was that I would be glad to meet with any candidate. I would love to see them vying to promote what could well be a popular and effective step in offsetting charges no one had a peace plan for Iraq.

Folk from elsewhere seem far more aware of a dividend program’s potentials than many Alaskan politicians, who covertly hate it simply because if they can’t get their hands directly on those dividend dollars, it compels them to consider cutting budgets or advocating new taxes. Both actions demand intestinal fortitude, seemingly in short supply these days.

At conference end, a professor of Economics who had written a book advocating dividends for other states and nations made a comment to the effect that conservatives in Alaska must love the dividend program since it is by far the most conservative thing that could have been done with their oil wealth. It makes a mini-capitalist out of every Alaskan, rather than spend all that oil wealth on government as would socialists.

Reflecting on this, it occurred to me that Alaska’s shift from “liberal” Democrat dominance prevailing prior to dividends to the “conservative” Republican stance of the present coincided exactly with their advent. I told him that, oddly, it is the so-called Democrat “liberals” who now seem the most ardent defenders of dividends. He found this as perplexing as do I.

In an article appearing in the *Wall Street Journal* in 2003,<sup>4</sup> Nobel laureate for economics Vernon L. Smith had this to say about Alaska’s Permanent Fund Dividend Program and its possible implication for oil rich countries such as Iraq:

With the capture of Saddam Hussein, President Bush has a great symbolic victory against his critics. However, the unfinished Iraqi economic reconstruction presents the President with a historic opportunity to craft a new geopolitical-economic paradigm . . . for the movement of assets from governments to citizens.

The last decades have seen a world-wide transfer of state owned assets to private entities, most often as governments have found themselves unable to afford their varying brands of socialism. However, this transfer of assets has served largely to generate funds for government—sales



to retire government debt, fund political priorities, or as an alternative for raising taxes—creating a funding system easier for politicians but more difficult for the public it serves.

For long-term success, the enormous task of nation rebuilding in Iraq requires attention to more than the creation of a political democracy. No matter how well-intentioned and democratic it might be, the next government will be tempted to corruption, violation of rights and expanded political power if it owns and controls the great economic wealth potential of Iraq. This is the time, and Iraq is the place, to create an economic system embracing the revolutionary principle that public assets belong directly to the public—and can be managed to further individual benefit and free choice, without intermediate government ownership in the public name.

There is a very important precedent, in part, for this action—the Alaska Permanent Fund. The State of Alaska elected to put a portion of its vast Prudhoe Bay annual royalty revenue into a citizens' Permanent Fund for investment in securities. Each year a dividend from this Fund is paid to every Alaskan citizen. This Fund was the first to recognize the full rights of citizens to share directly in the income from public assets.

This Fund, however, had important shortcomings that should not be repeated in the proposed Iraqi Fund.

Smith believes those shortcomings include failure to put *all* our state revenue from oil wealth into the people's account and using its earning for nothing but dividends. Instead, most of it went to state government. Says Smith:

When oil prices went up, the state succumbed to the temptation to repeal its income tax and spent its oil income like there was no tomorrow. Consequently, today the Alaska state government has a budget crisis and a deficit gap, but the 600,000 Alaskan citizens still share equally in the dividends from their Fund, now worth \$27 billion. [Its worth as of December 2011 is \$38.4 billion.]<sup>5</sup>

Smith believes that because it disciplines government spending and the political process, we should require politicians to tax dividend dollars back through what he terms “the eye of the needle of voter scrutiny” attending taxation and spending. Far better that than to let politicians have free priority access to what should be the people's earnings on their assets. Smith's article continues:

This action would launch the new Iraqi state as one based on individual human rights, and the rule of law, and anoint it with rock-hard credibility by giving every citizen a stake in that new regime of

political and economic freedom. The objective is to undermine any citizen sense of disenfranchisement in the country's wealth, economic and political future, and to galvanize citizen support for a democratic regime. Now is the time to act, before post war business-as-usual creates de facto foreign and domestic spoils of war property rights claims, leaving out a citizenry brutalized enough by a totalitarian regime, and in sore need of empowerment in their own future.

#### NOTES

1. Clemons 2003.
2. Hammond 1996.
3. Bezruchka 2002, 978.
4. Smith 2003.
5. Alaska Permanent Fund Corporation 2008.

A Cap on Carbon and a Basic Income:  
A Defensible Combination in the  
United States?

*Michael W. Howard*

The Permanent Fund Dividend (PFD) of the Alaska Permanent Fund (APF) can be seen as a successful example of a universal basic income. It is a partial, not a full, basic income, as it is not sufficient for basic needs. But like other basic income schemes, it is universal and detached from any work requirement. A basic income funded in this way is a natural resource dividend. The natural resource, in this case Alaska's oil, is owned equally by every resident, and every resident gets an equal share of the returns on wealth generated by the resource. This book asks how this model might be replicated in other contexts, and with other resources. Of the possible resource bases for a basic income at the federal level in the United States, one of the most promising is the atmosphere we all share, which, treated as a common sink, is becoming dangerously polluted with greenhouse gasses (GHGs). Limitation of this pollution through the auction of a fixed number of carbon permits will generate large revenues, and each of us might lay claim to an equal share of these revenues in the form of dividends, an idea popularized by Peter Barnes.<sup>1</sup> This is not mere speculation. The American Clean Energy and Security (ACES) Act, which passed the United States House of Representatives in June 2009, initially would give away 85 percent of the permits, but in the 2020s it would begin auctioning an increasing share of the permits and return the revenue to residents on an equal per capita basis. Comparable legislation did not pass the Senate in 2009. But one of

the bills placed before the Senate, the Carbon Limits and Energy for America's Renewal (CLEAR) Act, supports initial 100 percent auctioning of permits, with about 75 percent of the revenue set aside for rebates or dividends. (A similar bill had been introduced in the House by Congressman Van Hollen.) President Obama favored such a cap-and-dividend plan in his 2008 campaign and in his February 2009 budget proposal.<sup>2</sup> So it is accurate to say that a carbon dividend is on the agenda in the United States, even if legislation is temporarily stalled.

In this chapter, I will describe how a cap-and-dividend scheme, such as that in the CLEAR Act, might work. I will then present arguments in support of such a scheme. I will compare cap-and-dividend with the ACES Act, which has been called "cap-and-giveaway," and with alternative proposals for use of the revenue from a carbon auction (cap-and-invest; increasing the Earned Income Tax Credit).<sup>3</sup> I will discuss how cap-and-dividend might integrate with global efforts to reduce greenhouse gas emissions equitably. I will conclude with a comparison between a carbon dividend and Alaska's PFD.

The primary motivation for the family of policies including cap-and-dividend, cap-and-trade, and carbon taxes is to reduce GHG emissions, which the scientific community has determined are the principal cause of global warming and climate change. Failure to bring down GHG emissions, and thus to keep the rise in temperature to no more than 2 degrees Celsius, is likely to result in catastrophic consequences for the planet, including rising sea levels leading to flooding in heavily populated areas, more extreme heat waves, droughts, and floods, many species extinctions, water shortages, disruption of food supplies, and millions of climate refugees. Failure to reduce the human causes of global warming will contribute to positive feedback loops for other sources of global warming such as melting of polar ice caps and melting of permafrost, resulting in the release of methane. People in developing countries will suffer the most, but unmitigated climate change will be costly everywhere.<sup>4</sup> The nations of the world have recognized the problem, even if they have not yet agreed on the next step toward the solution. Belatedly the United States, after years of neglect, and despite the efforts by climate change deniers to sow confusion, has begun to develop a national policy aimed at reducing GHG emissions.

While many favor a carbon tax as the most direct and transparent method for raising the price of fossil fuels and creating incentives for shifting to renewable clean energy, some version of a cap-and-trade, or a cap-and-dividend scheme, seems more likely. The EU

has adopted cap-and-trade, and the United States has some positive experience with cap-and-trade schemes for other environmental pollutants.<sup>5</sup> Although prices are less predictable with carbon caps, defenders point out that the emission reductions are more predictable with a carbon cap than with a carbon tax. Both policies, cap-and-dividend and tax-and-dividend, can be seen as applications of the Alaska Model. Whether by selling carbon permits or by taxing carbon, the government raises the price of carbon to acknowledge the depletion of a common resource, the atmosphere, and generates substantial revenue, which can then be returned to citizens in the form of dividends. If the revenue were large enough, it could be invested in a fund, and the dividend would come from interest on the fund, as in the Alaska Model. Given a much smaller revenue stream per capita than that from Alaskan oil, it makes more sense to convert the revenue directly into dividends. In this chapter I will focus on carbon caps, but it should be kept in mind that a dividend could be as easily linked with revenue from carbon taxes as with revenue from auction of carbon permits. Placing a cap on carbon will impose costs on consumers, particularly lower income households. So the policy raises issues of economic justice, and that is where the dividend becomes important.

#### CAP-AND-DIVIDEND

Here is how a cap-and-dividend scheme might work. The government sets a cap, which could be “downstream” on emissions (as in ACES) or “upstream” on initial resources as they are introduced into the economy from the wellheads and mines, or at the borders.<sup>6</sup> Upstream resources are easier to monitor, as the sources are fewer and more visible. I will assume an upstream cap for purposes of this chapter. The government then sets a cap on the amounts of coal, natural gas, oil, and imported carbon-intensive products at levels determined by scientific requirements for reducing GHG concentrations. Any agency or company wanting to introduce carbon in any of these forms into the economy would need to buy a permit at auction. The price of the permit will be passed along in the prices for fuels and other products further downstream, and the higher prices for carbon will reduce demand and will make alternative energy more competitive. The auction will generate substantial revenue—hundreds of billions of dollars per year.<sup>7</sup> While some portion of the revenue could be set aside for government spending, say, for transitional assistance to workers displaced as a result of the higher fuel prices, in a robust cap-and-dividend scheme most of the revenue is returned to residents on an equal per capita basis. So,

for example, if the permit price were \$200 per ton of carbon, consistent with reducing emissions by 7 percent, this would generate revenue of “roughly \$200 billion per year.”<sup>8</sup> Hundred percent recycling of the revenues would yield a dividend of \$678 per person annually. Note that while this dividend could only be considered a partial basic income, insufficient for basic needs, it is roughly 50 percent of the amount of the PFD. If the permit price were \$25 per ton of carbon in 2020, a figure closer to that anticipated for the targets in either of the two bills discussed in this chapter, total revenue would be \$135 billion. The increased costs per person vary with income level. Those in the higher deciles use more energy, but those in lower deciles spend a higher proportion of their incomes on energy. So, increased energy costs, without any rebate, are regressive in their income distribution effects. However, if 75 percent of the revenue is returned to residents as a per capita dividend of \$297, 70 percent of the population would receive a net benefit. The net benefit for the lowest decile would be \$186. The net benefit falls gradually through upper deciles, the seventh receiving a net benefit of \$20, and the top three deciles receiving net losses of \$19, \$78, and \$211, respectively.<sup>9</sup>

Thus, one important reason for having a robust cap-and-dividend scheme is that it can achieve the environmental goal while preserving the incomes of low income and middle income households.<sup>10</sup> This is a matter of social justice. Other things being equal, social costs should be distributed in such a way as to benefit, or cause the least harm to, the least advantaged. In particular, the poor should not bear the burden of climate change mitigation. The cap-and-carbon auction will raise the price of fossil fuels (this will happen even if the permits are given away, because of the decrease in supply). Poorer households spend a higher proportion of household income on energy, even though they spend less per capita on average than upper income households. They will feel the burden of rising energy costs. If they receive a dividend that at least equals the average rise in energy costs for their income bracket, they will be relieved of this burden. Typically, with a 100 percent auction and 75 percent rebate, at least 70 percent of households in every state are net gainers.<sup>11</sup>

Richer households will receive a rebate too, because they too will have higher energy costs—higher per capita costs than the lower income households because they typically spend more, but lower per capita costs as a proportion of household income. Because of their higher consumption, typical households in the top three deciles will experience a net financial loss. Since energy costs will rise for everyone, all will have incentives to insulate their homes, reduce gasoline

consumption, and in other ways reduce their carbon footprints. The universality of the dividend is a way of signaling that we are all in this together. Everyone shares in the costs, but also in the dividends.

Cap-and-dividend is transparent. Everyone sees the rising fuel costs. And everyone receives a check or electronic deposit every month. This dividend is more transparent than a tax credit, which might achieve nearly the same transfer effect but is less visible and will exclude those who do not file a tax return. The dividend is much more transparent than benefits initially given to electricity-generating companies, who pass it through to customers in the form of lower electricity costs (one of the measures in ACES).

Cap-and-dividend is good politics, at least in principle. A majority of residents in every state will benefit financially, independent of the environmental benefits. The concept is simple enough that it can be easily explained and understood. (I say this is good politics, “at least in principle,” because, in the current corrupt state of our politics, made worse by the recent Supreme Court ruling in *Citizens United v. Federal Election Commission* that confers free speech rights on corporations as persons, the interests of energy companies compete disproportionately with the public interest, and successful legislation is a compromise between public and private interests.)<sup>12</sup>

#### CAP-AND-DIVIDEND AND ACES

A cap-and-dividend scheme such as I have described has been proposed in a bill introduced in the US Senate by Senators Cantwell and Collins, the CLEAR Act. A similar bill was introduced into the House a year earlier by Representative Van Hollen. The main competitor is the bill that passed the House, the ACES Act (H.R. 2454), also known as the Waxman-Markey bill, and a similar bill in the Senate introduced by Kerry and Boxer. Over a thousand pages long, the ACES bill is much more detailed. But, for our purposes, the main differences between it and the CLEAR Act are as listed below:

Under ACES, initially 85 percent of permits are given away rather than auctioned. Over time, the percentage of permits given away decreases, and the percentage auctioned increases.

The proceeds from the auction of the remaining 15 percent of permits are used by the government for a variety of purposes, including relief to low-income families.

There are fewer restrictions under ACES on permit trading and offsets than under CLEAR.

## AUCTION VERSUS GIVEAWAY

The giveaway of 85 percent of the permits was described by Peter Orszag, the press secretary for President Obama and former Director of the Congressional Budget Office, as “the largest corporate welfare program that has ever been enacted in the history of the United States.”<sup>13</sup> Defenders argue that “about 80 percent of the total available allowances are used to protect consumers from higher energy prices and for other public purposes.” For example, “approximately 22 percent of allowances are given to electric utility and natural gas local distribution companies, primarily in the early years of the program, expressly for the purpose of being passed on to consumers to offset higher energy bills.” Twelve percent goes to energy-intensive industries, to stave off competition from unregulated competitors from abroad.<sup>14</sup>

But keeping electricity rates low runs contrary to the purpose of the act, by failing to signal to consumers that there is a cost in using it. This pass-through benefit will be far less visible to consumers than a dividend. And they will only receive it if state regulators succeed in enforcing the pass-through. Moreover, “the burden of adjustment imposed by the carbon cap will fall more heavily on other sectors of the economy, including transportation fuels, pushing up prices in those sectors even more and raising costs to consumers overall.”<sup>15</sup> If the concern is to mitigate the rising costs of energy for consumers, why not give them the money directly, rather than filtering it through the utility companies?<sup>16</sup> If the cap were imposed upstream, as in the CLEAR Act, rather than downstream, as in the ACES Act, then it could be applied to carbon-intensive imports, thereby addressing the concern about carbon leakage from foreign competition. Carbon leakage occurs when buyers turn to imports that become cheaper than domestic sources of fuel because of the carbon cap on the latter. By imposing an upstream cap on the source of carbon, these imports are thereby included.

## DISTRIBUTION EFFECTS

ACES has some provisions to protect low income households, but these are not as progressive as cap-and-dividend. Already mentioned is the pass-through of value of allowances from utility companies. There is also a provision for rebates for low income households. Both the Environmental Protection Agency (EPA) and the Congressional Budget Office (CBO) did studies of the economy-wide costs of ACES.



Contrary to claims by the Heritage Foundation and others that the bill would cost thousands of dollars per household, both the EPA and the CBO project average net increases to household costs under \$200 annually.<sup>17</sup>

Somewhat challenging the claim that the 85 percent giveaway is merely a windfall for energy companies, the CBO study “concludes that 79 percent of the allowance value would eventually find its way back to American households.” But where a cap-and-dividend scheme would return 20 percent to each quintile, in the ACES scheme “in the year 2020 nearly two-fifths of the total (37.5 percent) would go to the top quintile of households ... The middle quintile would receive the smallest share (14.6 percent), with the remaining quintiles getting 15.4–16.9 percent each.”<sup>18</sup>

Thus, the ACES scheme is regressive in its effects on household income distribution, in comparison with cap-and-dividend. Some might argue that the amounts are small enough that this does not matter. Once the public sees how small the additional costs are and begins to enjoy the benefits from energy efficiency measures promoted by the act, resistance to cap-and-trade will vanish. This assessment is too optimistic. First, it ignores the relative visibility and simplicity of the dividend,<sup>19</sup> an important feature in a media environment of sound bites and toxic blogging. The benefits flowing from ACES are, in contrast, difficult to trace and easy to confuse with other sources, and costs from other sources, such as rising gasoline prices from world scarcity, are easily, if fallaciously, blamed on cap-and-trade.

Second, the policy must enlist popular support over decades, during which carbon fuel use needs to decline by 80 percent below 1990 levels. ACES begins with relatively small caps and puts off bigger emission reductions until later. So, what appear to be small costs per household may loom larger in later years, if the efficiency gains are not as great as hoped for and questionable new technologies that are subsidized by the allowances, such as carbon capture and sequestration, do not emerge as successful. In order to stabilize carbon dioxide in the atmosphere in the range of 450ppm CO<sub>2</sub>e (CO<sub>2</sub>equivalent), the Intergovernmental Panel on Climate Change recommends that countries such as the United States need to “hit a target of 25 to 40 percent below 1990 levels by 2020.”<sup>20</sup> What we need for a successful policy for the long run are up-front higher carbon prices, together with rebates that compensate most low- and middle-income households for the higher costs. This will be a simple and visible policy that can garner popular support in the face of what will be a difficult transition.

## CAP-AND-INVEST

Sometimes cap-and-dividend is contrasted with “cap-and-spend.”<sup>21</sup> Both policies involve a carbon cap and auction, but cap-and-dividend distributes all or most of the revenue as dividends, whereas cap-and-spend spends all or most of the revenue for such things as investment in renewable energy. It is a mistake, however, to oppose cap-and-dividend to policies for investment in renewable energy and the like. The question is whether the funds for such investment should come out of the revenue from a carbon auction, or from general tax revenues. For purposes of illustration I will take, as an example of cap-and-invest, the major study conducted by the Union of Concerned Scientists (UCS), referred to as the Climate 2030 Blueprint, which examines the energy and economic implications of a comprehensive suite of energy, transportation, and climate policies. The Blueprint includes a cap-and-trade scheme with 100 percent auction of permits and “recycling of auction revenues to consumers and businesses.” The study is not specific about how to recycle the revenues, but “the preferred approach would be to target revenues from auction of carbon allowances toward investments in energy efficiency, renewable energy, and protection for tropical forests, as well as transition assistance to consumers, workers, and businesses in moving to a clean energy economy.”<sup>22</sup> I support the case for such investments, but will argue that most of these should come not at the expense of a dividend, but from general tax revenues.

There is a strong case for substantial investment in renewable energy and rain forest protection, and for regulatory policies such as energy efficiency standards and fuel efficiency standards. Such policies can be expected to yield substantial net savings for businesses, households, and governments. The UCS study found that the cap-and-trade scheme alone (consisting of auctioning of all permits, recycling of revenues, limits on offsets to encourage reduction of carbon emissions, and permission for banking of allowances) would result in net savings of \$ 600 billion to consumers and businesses through 2030, but with the complementary policies for energy and transportation these net savings more than double to \$1.6 trillion.<sup>23</sup> This translates into average household savings in energy and transportation expenses of \$900 per year by 2030. These net savings will fall by more than half without the complementary policies, and the price of permits will rise. Under the blueprint, carbon permits will range from about \$18 per ton of CO<sub>2</sub> in 2011 to \$70 per ton in 2030. But without the complementary policies the price of permits will double.<sup>24</sup>

How should these policies be funded? It is tempting to agree with the UCS that the revenues from the carbon permit auction should be used to fund these policies. But it would be better to preserve a robust dividend and fund the policies through general tax revenues. Here is why. Suppose that the revenue from the carbon auction in a given year totals \$135 billion.<sup>25</sup> If 75 percent of this is distributed on an equal per capita basis to residents, the value of the dividend would be around \$297 per person for the year. If complementary policies totaling \$135 billion are funded out of general tax revenues, those in higher income deciles will pay more per person than those in the lower deciles, whether the dividends are taxable or tax-free.

On the other hand, if those same policies are funded with the revenue from the carbon auction, those in the lowest income decile will forego the same amount—\$297 per person—as those in the highest income decile, and they will be giving up a much higher percentage of their income. This amounts to a highly regressive head tax.<sup>26</sup> Thus, to bring about the fairest income distribution, the complementary policies should be funded from general progressive taxation, rather than from the auction revenues.<sup>27</sup> This issue is particularly important in the early years of the program when the investments that yield long-term savings are needed. The people hardest hit by initial rising energy costs need to be compensated so that they will not withdraw support for the policies.<sup>28</sup>

#### EXPANDING THE EITC

An even more progressive policy than a taxable cap-and-dividend involves expanding the Earned Income Tax Credit (EITC). Researchers modeled five different ways of using the revenue from a carbon auction. Using the revenue either to reduce income taxes or to reduce payroll taxes was regressive in its effects on income distribution. The lowest income deciles would have significant net costs from these policies, while the highest income decile would have small net gains. Cap-and-dividend policies were progressive, with taxable dividends producing a somewhat more progressive net effect on income distribution. But the most progressive policy considered involved using 14 percent of the revenue to increase the EITC by 50 percent. The remaining revenue would be used for per capita dividends. As the authors comment, “if we developed an EITC policy to use all of the revenue, the progressivity of this option would likely be even stronger.”<sup>29</sup>

Since the EITC is received only by wage earners, the increase for the lower income deciles as a whole would reduce somewhat the dividend for those ineligible for the EITC. This could be remedied if the EITC were made refundable, that is, converted to a negative income tax.

#### CAP-AND-DIVIDEND AND GLOBAL CARBON CAPPING

An essential question about any national climate policy is how well it integrates with global policies to address climate change. The problem of climate change is global. There is one atmosphere, and greenhouse gas emissions in one part of the globe affect the entire atmosphere. The global environmental problem is also a problem of global justice and development. Hitherto, getting out of poverty has depended on economic development, which has involved increased use of energy, and that energy has mostly come from fossil fuels. Nations on the development path should not be faced with a dilemma between causing catastrophic climate change and remaining in poverty. Most realize this already, as developing countries are likely to be hardest hit by the consequences of global warming.<sup>30</sup> But the atmosphere is rapidly approaching the saturation point, with CO<sub>2</sub> concentrations now at 383 ppm, and rising at a rate of about 2 ppm per year, a rate that is also rising.<sup>31</sup> Concentrations should not rise beyond 420 ppm to keep the world on the “2 degree emergency pathway.”<sup>32</sup> Business as usual will get us into the danger zone in about 15 years. To limit emissions and at the same time allow poor countries some room to develop, the wealthier countries must reduce emissions faster and also assume some of the responsibility for emissions and investments in the developing world. This will involve transfers of wealth in some form, and technology transfers. These obligations are supported by two ethical principles. The first is a polluter pays principle, which assigns responsibility to those who have knowingly been emitting more than their per capita allowance of GHGs (i.e., since about 1990). The second is an ability to pay principle. Those who cannot reduce their emissions without undergoing severe hardships should be helped by those who have the ability to do so. These principles are an interpretation of the UN Framework Convention on Climate Change, accepted by 181 countries in Rio in 1992, which stipulated that GHGs are to be stabilized at safe levels “on the basis of equity in accordance with their common but differentiated responsibilities and respective capacities.”<sup>33</sup> The polluter pays principle refers to responsibilities, and the ability to pay principle refers to respective capacities.

In terms of emissions targets, the United States and other wealthy countries need to cut emissions by nearly 6 percent annually from 2010, dropping to near zero. This means that emissions in 2020 would need to fall by 50 percent from 2010. (For comparison, ACES aims for 3 percent below 2005 levels by 2012, and only 17 percent by 2020. CLEAR has similar goals, but sets caps of only 5.9 percent below 2005 in 2020.)<sup>34</sup> Taking into account its responsibility, and also its capacity, the United States should be responsible for about 29 percent of the global emissions reductions. When this is projected over time, it becomes evident that if this obligation were to be met by national emissions reductions alone, the United States would need to reduce its emissions by 99 percent in 2025!<sup>35</sup> After 2025, emission reductions would need to exceed 100 percent, a physical impossibility. What this shows is that the obligation can only be met by helping developing countries (a) to achieve more than their per capita share of emissions reductions, and (b) to develop new technologies that are less carbon intensive.

A national climate policy needs to include “offsets,” despite the problems that these raise.<sup>36</sup> Offsets are reductions in GHG emissions elsewhere, or creation of carbon sinks such as new forests, to offset continued use of carbon above the permit level. Without offsets, it is literally impossible for the wealthier countries to satisfy their global obligations.<sup>37</sup> It is also even clearer, in a global context, why early investments in alternative energy and energy efficiency are a necessary part of climate policy. And finally, it should be clear that global solutions to the challenge of climate change will not be easy and cheap, but will require higher costs than current bills before Congress suggest, because of more stringent initial caps and because of international obligations for climate change mitigation and adaptation in developing countries. All the more reason to adopt policies that can sustain popular support, like a carbon dividend for all.

#### COSTS

How much higher will the costs be when international obligations are factored in? Assuming that the global cost of carbon mitigation and adaptation are about 1 percent of gross world product (GWP), and considering national responsibility since 1990, as well as capacity, the US burden would be around \$275 billion in 2020.<sup>38</sup> If roughly half of this is for mitigation and technology transfer in developing countries, this comes to \$137 billion. The costs could be higher.<sup>39</sup> The World Bank, the United Nations Framework Convention on Climate

Change (UNFCCC), and the EU estimate that total world costs for mitigation and adaptation are lower, in the range of \$100–200 billion in 2030. Using the Greenhouse Development Rights (GDRs) measure of obligation, the US share would be around \$12–24 billion, an order of magnitude lower than the estimate based on 1 percent GWP. Yet this is still substantially higher than anything provided for in ACES or CLEAR. The international provisions in ACES for deforestation, clean technology, and adaptation are about \$4.75 billion.<sup>40</sup> Of the 25 percent of auction revenues in the CLEAR Act set aside for nondividend purposes, about 15 percent (3.75 percent of the total revenue) might be used for international mitigation and adaptation, that is, about \$5 billion.<sup>41</sup>

This leads me to a possible dilemma. If the global costs of mitigation and adaptation are closer to the low estimates, then it will be possible for the United States to meet its global obligation out of part of the revenue from the carbon auction (or taxes on the dividends). Then the dividend will undergird domestic support for the carbon caps and foreign assistance. But if the higher estimates of global costs are more accurate, then the revenue from the auction will approach the amount needed to support developing countries in their mitigation and adaptation efforts—which efforts are crucial for successful climate change policy worldwide. In this latter case, enlisting popular support for carbon capping early on through a dividend may lead to entrenched opposition to meeting the international obligation later, when it would become necessary to direct much of the dividend to its rightful recipients in the developing world.

A CARBON DIVIDEND, THE ALASKA  
PERMANENT FUND, AND THE PERMANENT  
FUND DIVIDEND

This dilemma is similar to a problem that has arisen for the APF and PFD. The popularity of both of these institutions in Alaska may impede other uses of the revenue. This is arguably a positive thing in the case of the dividend, and a key to its long-term success.<sup>42</sup> But when Alaska abolished the income tax, relying on oil revenue to fund most of its state budget, it set the stage for a difficult choice, when the oil revenue runs out, between restoring other kinds of taxes, which is not likely to be popular, and diverting funds from the APF into government expenditures, also likely to be unpopular if this involves diminishing or abolishing the dividend. The Alaskan experience should lead those who craft a carbon dividend to think about the

politics of the dividend not only at the initial stages of implementation but also later as competing policies come into play.

To what extent is a carbon dividend an example of the Alaska model? Existing legislative proposals for a carbon dividend envision a dividend much smaller than the PFD, which has averaged \$1,400 per year over the past decade, so that the dividend might be thought to be nothing more than a small, inconsequential byproduct of environmental policy. To this worry one may reply, first, that even if it is only a quarter the size of the PFD, a carbon dividend on a national scale would be an unprecedented step, establishing a partial unconditional basic income for all. Second, since the motivation for the carbon dividend is to address the higher energy costs for low-income households resulting from the carbon cap, fairness is an explicit objective, and it is not unrealistic to expect that it might later be complemented by similar egalitarian policies with other sources of funding. Third, if most of the revenue from a carbon cap were used for dividends, if the cap were lowered to levels needed for a serious response to the challenge of global warming, and if consequently the price of carbon rose over much of the several decades of transition from fossil fuels, it is reasonable to expect the dividend to be at least half as big per capita as the PFD. Neither affords a full basic income, but neither would be inconsequential. There is room for expansion in each case. The APF could be redesigned to cover additional resources, and a higher proportion of the APF revenue could be distributed as dividends. Both the PFD and a carbon dividend could be complemented by other basic income policies, such as a refundable EITC. What is important about each, from the point of view of basic income policy, is that each is an unconditional income, funded from commonly owned resources. At the state level, and the national level, each can perhaps begin to legitimize the idea of citizens receiving income decoupled from work.

Some may argue that crafting a basic income as a resource dividend diverts attention away from other policies, such as the EITC, that might get closer to a full basic income, or at least a partial basic income at a guaranteed level, less tied to the volatility of commodity markets.<sup>43</sup> Volatility is a concern, particularly if one thinks of a basic income as a steady stream one can count on. The carbon dividend could be expected to rise with the demand for permits and for carbon fuel, but it could also be expected to decline as renewable energy begins to displace fossil fuel. However, the fluctuations in the dividend could be expected to mirror and be balanced by fluctuations in household energy costs for which the dividend is supposed to compensate. Further, the objection

underestimates the popular resistance to cash transfers from general tax revenues and the political difficulty of extending the EITC to nonworkers. While this is not a reason to abandon efforts to extend the EITC and convert it into a negative income tax, a carbon dividend may be the easiest point of entry into American political consciousness for the idea of universal income decoupled from work or conditional entitlement. Whether the idea of a universal basic income might later be detached in popular opinion from its original justification as a resource dividend remains to be seen.

The likelihood of a carbon dividend is increased by the fact that the right to pollute, embodied in the auctioned permits, was previously unowned, like the oil wealth on which the APF and PFD were based. Creating resource dividends based on assets that have already fallen into private hands encounters much greater obstacles from vested interests. Once created, the carbon dividend can be expected to be resilient in the face of efforts to eliminate it, like the fund and dividend in Alaska. The APF is constitutionally guaranteed, but the PFD exists only as a result of legislation, whereas both the carbon cap and the carbon dividend would only be as secure as the continuing legislation allowed. However, the PFD is enormously popular, and difficult to repeal. So too, a carbon dividend might be expected to become popular once it is in place, and difficult to repeal, reinforcing not only the partial basic income policy but also the carbon capping policy. Thus in the Alaskan case and in the case of the carbon dividend, the institutions for funding and for distribution are mutually reinforcing.

The APF is designed to preserve wealth in perpetuity for future generations. The funding from a carbon auction has not been designed to do this (although it could be set up in this way, at the price of a lower dividend). The carbon dividend is a temporary policy, designed to ease the transition to a carbon-free economy. Nonetheless, that transition is likely to take decades. In the meantime, the potential significance of a carbon dividend as one element of egalitarian distribution policies, as a model of a partial basic income that might be extended, and as a possibly growing and thus more salient component of household incomes, should not be underestimated.

#### NOTES

1. Barnes 2008.
2. Reich 2008; Zabarenko et al. 2009.
3. Boyce and Riddle 2007 and Barnes 2008 use the term “cap-and-giveaway.”



4. IPCC 2007; CIER 2007; Ackerman and Stanton (2008) estimate the probable cost to the US economy of business as usual to be 3.6 percent of GDP in 2100.
5. Reilly and Paltsev 2006 ; Ellerman et al. 2003.
6. The ACES Act sets the cap downstream, on emissions. Many emissions, such as exhaust from automobiles, would be difficult to monitor, so the bill focuses on large emitters such as electrical generating plants, which would need permits for their CO<sub>2</sub> emissions. The CLEAR Act sets an upstream cap on the unprocessed and unburned resources, coal, oil, and gas, at their points of entry into the economy at the mine, the well, or the border.
7. Paltsev et al. 2007, 2.
8. Boyce and Riddle 2007, i–ii.
9. Boyce and Riddle 2010, 4–6.
10. Boyce and Riddle 2007.
11. Boyce and Riddle 2010.
12. Liptak 2010.
13. Quoted in Sassoon 2009.
14. Pew Center 2009.
15. Boyce and Riddle 2009, 17.
16. Boyce and Riddle 2009, 17–18.
17. The Congressional Budget Office found that “costs in 2020 would average \$175 per household and that those in the lowest twenty percent by income would actually receive a net benefit of \$40 per year.” The EPA analysis, taking account of “offsets and the use of allowance [i.e., permit] value . . . concludes that costs could be on the order of \$80–111 per household annually for the period from 2010 to 2050” (Pew Center 2009). There are problems with offsets, having to do with verifiability and weakening the environmental effects of the legislation. So if offsets were removed, it is possible that the costs per household would be significantly higher. But my concern here is not with the net cost, but the way it is distributed.
18. Boyce and Riddle 2009, 17.
19. Boyce and Riddle 2009, 17–18.
20. Romm 2009.
21. Boyce and Riddle 2007, 4.
22. Knobloch 2009, 11; cf. Union of Concerned Scientists 2009, 14n3.
23. Knobloch 2009, 3–10.
24. Knobloch 2009, 8–9, 12.
25. This is the estimate for 2020 by Boyce and Riddle 2010.
26. Boyce and Riddle 2007, 16.
27. There may be other alternatives to raising taxes—such as redirecting federal subsidies given to the fossil fuel industry, valued at \$24 billion annually, toward renewable energy and efficiency (Andrews 2007, cited in Boyce and Riddle 2007, 16).
28. Boyce and Riddle 2007, 15.

29. Burtraw et al. 2009, 22.
30. Friedman 2008.
31. Romm 2009.
32. Baer et al. 2008.
33. Quoted in Singer 2008, 671.
34. Sheppard 2009; Cantwell 2009.
35. Baer et al. 2008, 2, 6–7.
36. Paltsev et al. claim that “international emissions trading would not lead to substantial long-term economic efficiency gains for the U.S. . . . Rather, such global emissions trading is probably best thought of as an instrument by which the U.S. (and perhaps other developed countries) might induce developing countries to take on an emissions commitment by implicitly agreeing to pay for their reductions by awarding them allowances that we will then purchase back to meet domestic targets” (2007, 3).
37. Howard 2011.
38. Baer et al. 2008.
39. Stern’s revised estimate is around 3 percent of GWP, quoted in Baer et al. 2008; see also Ackerman 2009.
40. Pew Environmental Group 2009.
41. Boyce and Riddle 2010.
42. Bryan and Castillo, in Widerquist and Howard 2012a.
43. See articles by Zelleke and Lewis in Widerquist and Howard 2012a.

A Permanent Endowment for  
the United States

*Karl Widerquist*

In the opening chapter of this book, Michael W. Howard and I defined the “Alaska model” as a (1) resourced-based (2) permanent endowment (3) used—at least partially—to fund unconditional cash dividends to all citizens or all residents. This chapter focuses on the second feature: the permanent endowment. Extrapolating from Gary Flomenhoft’s estimates for Vermont,<sup>1</sup> this chapter argues that the United States can create a permanent resource-based endowment that could finance both a substantial dividend and a significant portion of government spending, perhaps nearly *all* government spending. Of course, a major jurisdictional issue would appear if the state and the federal governments of the United States were to attempt to create an endowment out of the same resource revenue at the same time. This chapter does not address that issue, but readers should be aware of it.

Flomenhoft’s findings for Vermont give a rough idea of what resources might be available to build an endowment for the United States. Although Flomenhoft puts his data toward one specific use (estimating the potential size of a Vermont dividend), other equally interesting calculations, with broad implications, can be made from his findings. This chapter focuses on the most important of these: the percentage of GDP attributable to common-asset rent.

Flomenhoft estimates the rent on common assets including the atmospheric sink, wildlife, fish, forests, groundwater, surface water, minerals, the broadcast spectrum, wind (for wind power), land value,

the Internet, the financial system, and money creation.<sup>2</sup> His list of common assets is not exhaustive, but it is very extensive.

Flomenhoft's low estimate of total available economic rent in Vermont is \$2.02 billion, and his high estimate is \$6.45 billion.<sup>3</sup> In 2005 Vermont's GDP was \$22.77 billion. Dividing the low and high figures by GDP gives a low and high estimate of the portion of Vermont's output that is being captured as rent: 8.86 percent and 28.31 percent, respectively.

Flomenhoft recommends caution in using figures this way, because capturing many of the rents discussed in his article would involve a significant reorganization of the economy, such as creating a market for pollution tax credits where none exists today.<sup>4</sup> It would take years to accomplish the goal of capturing these rents, and the amount of rent that the people could capture is difficult to estimate, which partially explains the large gap between the low and high estimates. But these are the best figures we have, and if we use them cautiously, they can give us some idea of the possibilities.

If Flomenhoft's figures for Vermont are representative of the United States as a whole, rents on common assets are between 8.86 and 28.31 percent of US GDP. The US GDP was about \$14.6 trillion dollars, or \$47,000 per person, in 2010.<sup>5</sup> If the low estimate is correct, common assets can produce \$1.28 trillion of revenue per year. For simplicity, assume half of it will go for a dividend and half for regular government spending. Of course, many other divisions of the returns are possible, but this short chapter discusses only one obvious division.

Using half of that (\$640 billion) for the regular budget would cover 25 percent of US government spending (\$2.5 trillion) or 91 percent of the US military budget (\$698 billion).<sup>6</sup> The other half would fund a yearly per capita dividend of \$2,080, or about \$8,320 for a family of four, not enough to live on but enough to make a serious difference in people's lives.

If the higher figure is representative, the amount of rent captured will be 28.31 percent of \$14.5 trillion, or about \$4.10 trillion. Half of that (\$2.05 trillion) could fund 82 percent of the US government budget. The other half could fund a dividend of \$13,300 for every man, woman, and child in the United States, or \$54,200 for a family of four. This dividend would eliminate poverty in the United States, make a big difference for the middle class, and make a difference even for many young members of the upper class.

Obviously, private individuals will have to pay these rents, but remember that those rents will be replacing existing taxes. People

would be freed from complex and burdensome taxes, which would be replaced with simple rents that are much simpler to calculate and pay. Rent financing also comes with an efficiency-improving side effect: if you don't like paying resource rents, use fewer resources. Such a system charges people who use (and use up) more of our common heritage and reward people who use less.

It is possible that a basic income of \$13,300 could replace much current government spending aimed at maintaining people's incomes. If the dividend can replace 18 percent of government spending, it is possible that a resource endowment at this level could fund the rest of the US budget at the same time that it funds a basic income of \$13,300.

Again, the exact size of the possible endowment is uncertain because it is hard to estimate the price of goods that are currently given away. These estimates give only a tentative indication of how big the possibilities are. We won't know exactly how large the resource endowment can be until we create one. But before concluding, I will argue that, large or small, some endowment is better than none.

The government should have taxes if they are necessary, but if they aren't necessary, who wants them? If the government had a rent-producing stock of wealth (a sovereign wealth fund like Alaska's Permanent Fund Dividend and/or government-owned resources rented out to private individuals), some portion of taxes would no longer be necessary. The government might have some equality-based goals for taxing higher incomes more than lower incomes, even if resource taxes are in place. However, this goal might be achievable through resource taxes as well, if resource taxes are being imposed on previously privatized resources as well as newly privatized resources. Private resource ownership, especially ownership of income-producing resources, is as unequal as income. Taxing these resources might achieve some or all of the increased equality that progressive income taxes are supposed to achieve.

It is much easier to pay rent for the resources you use than to deal with complex accounting rules that cost corporations billions of dollars per year to avoid. For example, in 2010, the Alaska state GDP was \$49.1 billion.<sup>7</sup> State government revenue was \$10.5 billion.<sup>8</sup> Therefore, the state's "tax burden" for Alaskans was 21.4 percent. But if you ask most Alaskans about their state's tax burden, they will probably say that their state has none: the state government supports itself. The state has revenue because the state owns the North Slope's mineral rights. Individuals support the government's endowment by

refraining from owning the North Slope's mineral rights, but there are many other things that individual Alaskans don't own. They don't own what Shell, BP, or Exxon-Mobile have either, but they hardly feel that they support these companies by refraining from owning what these companies own. They don't own Harvard, Yale, or Stanford universities' endowments, but they don't feel that they support those institutions either. No one supports an endowment; it makes its own money through rent and sales.

The land, atmosphere, and water of this planet belong no more to anyone of us than to all of us. These assets (along with jointly created assets, such as our monetary system) constitute a commons from which we can build an endowment. Many progressive policies are just as feasible, if not more feasible, by a government that has a permanent, asset-based endowment than by a government that relies on revenue from taxes on incomes and other sources.

Many private institutions, even nonprofits such as universities, start with a small endowment that grows on an average rate every year. Governments seem to do the opposite: they allow our commons to shrink every year, and have no lasting endowment to show for it. Almost all the land and minerals of the United States were once owned in the name of the people by the US federal government. Of course, the United States obtained those assets through sometimes-nefarious purchases, cessions, and seizures from other organized governments or from native peoples with and without organized governments. But what concerns me here is not the wrongs that may have occurred at the establishment of claim, but the less-discussed wrong of what happened next. The government did not distribute those resources consistently with equality, equal opportunity, merit, finder-keepers, or any other reasonable principle of justice. It didn't sell or rent them to the highest bidder for the maximum benefit of the people, as Alaska's constitution would have it. It gave away its potential endowment, often to the politically connected.

Twenty years ago, Russia had a similar opportunity with the enormous commons the people had just reclaimed from the Soviet dictatorship. But state assets quickly went into the hands of political insiders, who gave the people little or nothing in return. All around the world, new mines open, forests are destroyed, and new pollutants enter our air and water; our commons shrink and the people receive nothing for it. A shift from income, sales, and property taxes to a permanent endowment based on common asset rents can reverse this trend and relieve the most burdensome forms of taxation.

## NOTES

1. Flomenhoft, this volume.
2. Flomenhoft, this volume, XXX to XXX.
3. Table 6.1, Flomenhoft, this volume, XXX.
4. Gary Flomenhoft, personal correspondence.
5. World Bank 2012.
6. World Bank 2012.
7. Usgovernmentrevenue.com. Web. January 11, 2012.
8. Groh, this volume.





Exporting the Alaska Model to Alaska: How Big Could the Permanent Fund Be if the State  
Really Tried? And  
Can a Larger Fund Insulate an Oil Exporter from the End of the Boom?

*Karl Widerquist*

If we think of the Alaska model as a resource-based or common-asset-based endowment capable of permanently funding a dividend and/or a significant portion of government spending, the combination of the Alaska Permanent Fund (APF) and Permanent Fund Dividend (PFD) embody this model, but only in a small way. Less than one-fifth of the state of Alaska's oil revenue has gone into the APF; Alaska captures a much smaller portion of oil rents than many other oil-exporting nations; and Alaska has not attempted to build any kind of endowment out of most other common assets. Therefore, enormous potential exists to export the Alaska model not only abroad but also back to Alaska.

This chapter discusses two questions about the potential for an Alaskan resource endowment. What size resource endowment would have been possible had the state made it a central priority from the start? Given where the state is now, what are the possibilities for building up a permanent endowment in the future before oil revenues begin to decline? The first of these two questions will be more interesting to other places (such as North Dakota, Mongolia, and South Sudan) just at the beginning of their resource boom and to whichever

state or nation that might experience the next resource boom. The second question will be more interesting to Alaskans looking ahead to the eventual decline of state oil revenue. Before section 3 gets to these questions, section 1 discusses the need for, and the potential of, resource-exporting nations to convert a temporary resource boom into a permanent resource endowment, and section 2 explains the specifics of the kind of resource endowment system examined in section 3.

## 1. THE POTENTIAL FOR A RESOURCE ENDOWMENT

Chapter 11 argued that most governments can establish a large, permanent resource endowment capable of sustaining both a dividend and a significant portion of regular government spending—perhaps even all of it.<sup>1</sup>

On a temporary basis, several national and regional governments around the world are already financed almost entirely by their common endowment. Over the past 30 years, 85 percent of Alaska's state government revenue comes from the oil fields it owns.<sup>2</sup> Most of the oil-rich states of the Arabian Peninsula have no taxes, funding all or most government activity from resource revenue. Unfortunately, these resource revenue sources are temporary and all of these governments are doing a poor job of turning their temporary revenue streams into permanent endowments.

This situation ought to be distressing. We cannot know that a resource-rich state has escaped the resource curse until the resource boom is over. As I see it, the resource curse can take at least three different forms. First, it can drive up the nation's exchange rate and drive other industries out of business. Second, it can foster corruption, graft, and sometimes dictatorship, so that all or most of the oil revenue is used against the people rather than for their benefit. Third, it can create temporary prosperity for all or most of the people, only to lead to depression and economic deprivation as soon as the resource revenue disappears.

The first two forms of the resource curse will be apparent during the boom. But the third becomes obvious only later. Alaska and several other resource-exporting states and nations have clearly escaped the first two forms of the resource curse, but they might still be vulnerable to the third form.

There are two common strategies to avoiding this third kind of resource curse: establish Sovereign Wealth Funds (SWFs) to save part

of the temporary resource-revenue in a portfolio of investments for use later; create the right infrastructure so that the economy will thrive on other industries when the resource exports dwindle. There are many potential pitfalls with both strategies.

Most major resource-exporting nations have SWFs that save some of their temporary revenues. But none of these SWFs (including the APF) is large enough to endow the entire government when the temporary revenue source is gone. If the Alaska state government had to rely entirely on the APF, the state would run through all the funds that the APF has accumulated since 1976 in less than four years. Alaska has increased its SWF, but some governments draw on their SWFs frivolously, and very little is left when funds are most needed.

Infrastructure can be a great solution, but it is vulnerable to both corruption and error. It is very easy to mask graft as infrastructure spending, and even well-meaning governments cannot be sure that the type of infrastructure investments they make will be the best, or be even effective, in building a capable economy that will thrive when resource exports are gone.

Any resource-exporting government that puts its people at risk of the third kind of resource curse by spending all or most of the temporary resource revenue as it comes in, without a solid plan to create a permanent endowment, is foolish and shortsighted. This chapter argues that resource-exporting governments can permanently escape the resource curse through a combined strategy of building up their SWFs as much as possible and looking beyond the SWF toward renewable and permanent resources that can permanently endow a government without going through the mechanism of an SWF.

## 2. A SIMPLE SPLIT BETWEEN DIVIDEND AND SPENDING

A resource endowment can be used to finance a dividend or any other form of government spending. Some left-libertarians would use the whole of it for regular government spending, which would include more traditional, conditional welfare programs rather than a dividend or a basic income. Jay Hammond favored using the whole of Alaska's oil-based endowment to fund the dividend and maintaining the income tax for all or most regular government spending.<sup>3</sup> Michael W. Howard (coeditor of this volume) favors this approach as well, and we discuss it in our final chapter.

This chapter assumes that returns to the endowment (after inflation-proofing and reinvestments) will be divided into two halves: one-half

for a dividend, one-half for regular government spending. There are three reasons the discussion here focuses on a half-and-half division. First, it is a simplifying assumption that makes the math very easy.

Second, when one considers a fully employed Alaska model with a large resource base, the potential endowment becomes so large that the returns can fund both a very large basic income and a substantial amount of other spending. If half of the returns to the resource endowment can support a basic income far larger than what is required to eliminate poverty, it is reasonable to use the rest of the returns for other pressing needs, such as schools, infrastructure, the police, the courts, and so on.

Third, at the conference on “Exporting the Alaska Model” in Anchorage in April 2011, many of the participants agreed that there is something in the APF and PFD for everyone—except for the politicians. Voters who prefer small government bureaucracy like the dividend. Voters who prefer an active government that helps people like the dividend. Rural, suburban, and big city voters all like the dividend. Rich or poor, it’s good to have money deposited into your account every October. But politicians don’t like the dividend because they can’t do anything with it. They like to control the budget. Dividing the endowment half-and-half might get politicians on board with the resource endowment. Getting some of Alaska’s oil wealth out of the day-to-day discretion of the government was one of Jay Hammond’s central goals in setting up the fund and dividend, and he had good reasons for doing so, but some of what politicians do is necessary. If politicians use their entire budget for graft and waste, it’s best not to give them any budget at all, but if we need some of what the regular government budget provides, a resource endowment is one good way to finance it.

### 3. A PERMANENT ENDOWMENT FOR ALASKA

This chapter looks at the possibilities for an Alaskan resource endowment in two ways. The first examples look at what would have been possible if Alaska would have made the creation of the largest possible resource endowment its goal from the very start. This kind of idea was considered when the oil money started coming into Alaska in the mid-1970s.<sup>4</sup> Of course, we can’t change history now, but it is extremely valuable to go through this exercise looking backward with numbers that weren’t available looking forward in the 1970s. This exercise reveals the enormous possibilities of a resource windfall such as the one that Alaska is experiencing. Later examples look forward from where Alaska is now.

The APF has fluctuated around \$40 billion recently.<sup>5</sup> This endowment got accumulated from deposits totaling \$18.4 billion between the creation of the fund in 1976 and 2010 (new investments continue each year). Thus, even though the fund has paid 30 years of dividends, the principal has increased by a total of 217 percent over its initial investment (adjusted for inflation). The most recent dividend was \$1,174 in October 2011, and dividends have tended to be between \$1000 and \$2000 per person per year for the past 15 years. According to Erickson and Groh, the state received a total of \$103.5 billion in oil revenue over that period. The remaining \$84.4 billion has gone mostly to the general state budget, although some of it has gone into other funds, such as the Constitutional Budget Reserve.<sup>6</sup> In percentage terms, the rules of constitutional amendment that established the APF have earmarked only 11.4 percent of total state oil revenue for the fund between its inception and 2010. Occasional additions made by the legislature have brought the total to 18.2 percent of Alaska's government oil revenue.<sup>7</sup> But most of the other 81.8 percent of Alaska's government oil revenue was spent as it came in.

To get an idea about how big the APF could have been, we need to look at what has happened to the oil money generated in the State of Alaska, estimate what could have been done with it, and then consider other possible resource revenues. The following three examples consider three different scenarios about what might have been.

**Example 1:** Assume that instead of eliminating the income tax the state decided to deposit all oil revenues into the APF.<sup>8</sup> Assume that the state decided to split the returns to the fund evenly between paying the PFD and supporting the regular state budget. Assume that the state adopted the rule of spending 4 percent of the market value of the APF each year, and assume that this, on average, is about the same percentage that actually has been paid out in dividends, on average, each year. Assume the fund's \$103.5 billion of hypothetical investments performed as well as its actual investments of \$18.4 billion.

Under these assumptions, the APF would have stood at \$225 billion by 2011. Under the 4 percent of market value rule, it would have \$9 billion available this year, \$4.5 billion for state spending and \$4.5 billion for dividends. If all 700,000 Alaskans applied for the PFD, each would receive a dividend of more than \$6,400. A family of four would receive more than \$25,700. Instead of receiving the once-year bonus of \$1,000–\$2,000, Alaskans could count on regular payments of more than \$500 every month. Current total state spending is

\$10.5 billion per year. The \$4.5 billion in APF returns devoted to the state budget would cover 43 percent of the state's annual spending; income taxes could be reduced or services increased accordingly.

But example 1 is not the limit of how big the APF and PFD could be. According to Erickson and Groh, oil produced in Alaska has generated more than \$300 billion in total revenue, two-thirds of which has gone to oil companies. Fees, royalties, and taxes on Alaskan oil are low by world standards. Some nations capture as much as 80 percent of oil revenue.<sup>9</sup> Even though the oil was discovered by state geologists on state land, and the oil companies were brought in only as hired help, the state didn't drive a very hard bargain and received much less than the market rate for the oil fields they still own. Let's see what the state could have done by driving a harder bargain.

**Example 2:** Assume the state managed to capture about two-thirds of the total market value of oil produced in Alaska, still less than what Norway, Russia, and many of the Middle East nations capture.<sup>10</sup> The rest of the assumptions remain the same as in example 1. If so, the state would have deposited \$200 billion into the APF over the past 33 years. The APF would be worth \$434.8 billion. It would have \$17.4 billion available this year, \$8.7 billion for the general budget and \$8.7 billion for dividends. The share going to the state budget would cover 83 percent of state expenditure. The state would need to raise only \$1.8 billion in taxes to cover all other current spending. Assuming the population of Alaska remains unchanged at 700,000 (which is admittedly a very big assumption at such a large dividend level, see below), every Alaskan would receive a dividend of more than \$12,000 per year, perhaps in payments of \$1,000 per month or \$250 per week. For a family of four, that amounts to nearly \$50,000 per year, \$4,160 per month, or \$1,000 per week. Poverty would no longer exist in Alaska, and everyone, rich or poor, would have a large springboard of opportunity.

But this amount is still not as high as the APF could go. The APF in example 2 is based on oil resources alone. If the state applied the same model to all of Alaska's resources, the APF could be higher still. I have no data on the total value of Alaska's other resources. However, using Gary Flomenhoft's estimates for Vermont gives a range of 8.86 to 28.31 percent of GDP for the value of rents on common assets.<sup>11</sup> If we assumed something in the middle, that the natural resources other than oil make up about 15 percent of Alaska's economy of \$45 billion per year, it would amount to about \$6.8 billion dollars per year or more than \$200 billion over the past 30 years. But let's be more conservative.

**Example 3:** Assume that Alaska could raise half as much from all its other resources put together (including fisheries, water, land, the broadcast spectrum, etc.) as it could have raised from oil over the past 33 years, as shown in example 2. The value raised from oil was \$200 billion. So, assume that the other resources could have raised \$100 billion over the same period. Under this assumption, the state would have deposited more than \$300 billion into the APF from both oil and other resources. The total value of the APF would now be about \$650 billion (making it one of the largest SWF in the world). Its returns would produce \$13 billion per year for the state budget and another \$13 billion for dividends, which would be more than \$18,000 per person per year—more than \$1,500 per month, and more than \$380 per week for every man woman and child in Alaska. The state could eliminate all taxes. User fees on state resources would produce revenue enough to finance these dividends and the entire current state budget of \$10.5 billion, and it would still have \$2.5 billion leftover for greater spending, saving, or dividends.

As a best-case scenario, this example is rosy, but how rosy is it? The assumptions about the returns to the fund's investments are realistic; our hypothetical fund does no better and no worse than the actual fund has. The assumptions about how much money the state could have gotten from the oil industry are also realistic; they are in line with what many oil-producing nations actually do receive. The assumption about revenue from other resources is a reasonably conservative guess in comparison to the hard data available for Vermont. Certainly the revenue available from other resources is much greater than zero in such a large, resource-abundant place as Alaska. Thus, even if the total resource revenue available were less than in example 3, it would still be more than in example 2. Therefore, estimates of the resources available or the likely returns do not make the estimates into rosy scenarios, but two other factors do.

First, although the current dividend of \$1,000 to \$2,000 per person per year probably does not have a large effect on the size of the population of Alaska, a dividend of more than \$10,000 a year would create a large demographic distortion. To maintain a dividend that large, Alaska would have to do one of several things: (1) accept a significant demographic distortion, (2) make some kind of deal with the federal government to control migration from the rest of the country, (3) make a deal with the federal government to deny dividends to new migrants for a significant amount of time, (4) make a deal with the federal government to introduce a similar resource dividend for the rest of the country, which would offset some or most of the

migration pressure, or (5) negotiate independence. Of course, the state could instead reduce the size of the dividend, but this strategy is not certain to reduce demographic distortion, because the state is obliged to spend the money on something that benefits Alaskans, and any spending on Alaskans (especially spending that large) will cause demographic distortion.

Second, these examples ignore that the state had a strong need to spend some of the oil money as soon as it came in. When oil money started coming in, Alaska 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, much of it was well spent. As David Rose, the first director of the Alaska Permanent Fund Corporation (APFC), argues, “Until basic needs are met, such as education and public safety, the government has no business saving for the future.”<sup>12</sup> Alaska had to spend a lot to meet its needs at the time. Even if the income tax had remained in place, Alaska could not have saved as much as the higher estimates show without unacceptable cost in delayed capital improvements, delayed educational investment, and so on. I cannot say how much this factor affects the potential size of the APF. To determine this, one would have to estimate how much investment was needed, how much of that cost could have been paid for out of income taxes, and how much would have had to come out of taxes on oil and other resources.

However, it is safe to say that Alaska could have saved much more of its oil wealth than it has saved or than it is currently saving. It could have waited to get rid of the income tax until returns to the APF made the income tax unnecessary; it could have driven a harder bargain with the oil companies; and it could have applied (and it could still apply) the Alaska model to more than just oil and mining.

Had the state done all of this, the APF would now be in the hundreds of billions of dollars—perhaps eight, ten, or twelve times its current size. The state government and the dividend would be nearly invulnerable to the coming decline in the oil revenue because neither would be relying on oil revenues for yearly expenditures. It is this fully employed Alaska model that other states and nations facing the possibility of a resource boom should look to as an example. Any government undergoing a resource boom faces a difficult trade-off between building up a permanent endowment and spending now on infrastructure, education, and other pressing needs. But my observation of resource-rich governments tells me that all of them, with



the possible exception of Norway, are systematically making the same error: devoting far too much toward current spending and far too little toward the creation of a permanent endowment.

It's not too late for Alaska to put more money away into the APF. The state could start saving all of its oil revenue today. It has recently raised fees and taxes on oil companies, but it might have room to get tougher still. And the state can always apply the model more widely to more resources, many of which can produce permanent rather than temporary revenue streams. If Alaska wants to be ready when the oil runs out, the government needs to take steps in this direction right now. The following example looks at the possibilities for the state starting where it is now.

**Example 4:** Suppose Alaska starts now to save its oil revenue in preparation for the day that exports begin to run low. Current Alaska state revenue is \$10.5 billion dollars, of that, 85 percent comes from oil.<sup>13</sup> That's about \$8.9 billion of oil revenue. No one knows for sure when that revenue will begin to decline or at what rate. Let's assume the state will make \$8 billion per year in oil revenue for the next ten years, and let's look at where the state budget could be in ten years if Alaska begins now to save that entire \$8 billion per year of oil revenue, making up for it in the state budget by reintroducing the income tax or some other statewide tax.

Assume that the state puts that \$8 billion per year in a separate, temporary fund under management of the APFC for ten years—call it the special ten-year account. This money sits and accumulates for ten years, while the regular APF and PFD continue with all the current rules in effect. In 2022, the state deposits all the money and returns that have accumulated in the special ten-year account into the APF. The state then begins distributing the returns from the enlarged APF as in the above examples: half for dividends and half for the general budget. Assume the money in the special ten-year account grows at 6 percent per year (about what the APF has averaged over the last 30 years). If so, by 2022, the special ten-year account would be in position to deposit more than \$90 billion into the APF. How much money would the APF itself have by then? Assume that between new deposits and returns over and above the amount paid out in dividends, the APF grows by 3 percent per year over the next ten years. The APF uses a fairly conservative inflation-proofing formula, and it has done better than 3 percent per year over its dividends, and so I choose this figure to estimate conservatively. If the APF grows at this rate, by 2022, it would be worth

more than \$50 billion *before* the deposit from the special ten-year account is made. After that deposit, the APF would have a balance of \$140 billion.

A withdrawal of 4 percent of the market value of the APF would provide \$5.6 billion dollars, \$2.8 billion for dividends and \$2.8 billion for government revenue. The portion dedicated to the general budget would replace more than 25 percent of state government revenue, and it would therefore finance an enormous income tax cut. The portion dedicated to dividends for 700,000 Alaskans would produce \$4,000 for each resident (\$16,000 for a family of four). Even if the oil ran dry that year, the state would be in a position to *cut taxes* and *increase* the dividend—the opposite of what the state will probably do if it continues on its current course until oil exports begin to run low. There is still time to make the day of reckoning painless for Alaskans, but it will take a sacrifice of higher taxes in the short run to prepare for that day now.

If state oil revenue remained stable for another 20 years, and the state stuck with this plan, the APF could be worth more than \$245 billion in 2032. The returns on the APF would exceed the state's oil revenue, and at more than \$9 billion per year, they would produce more than \$4.5 billion for dividends and more than \$4.5 billion for state revenue. Dividends could be 6,000 per person (\$24,000 for a family of four),<sup>14</sup> and income taxes could again be cut or services increased.

This plan is economically feasible, and, I believe, Alaskan voters whose top priority is the fiscal and economic health of their state in 10 or 20 years will look favorably on it. But it is a tough sell politically. It involves a jarring (though temporary) income tax increase in a state where many voters hope to be permanently free of the income tax. The payoff for the income tax now would come ten years in the future, by which time at least some voters plan to have moved elsewhere. A gradual phase-in of the income tax would make the plan easier to accept for individuals planning their spending over the next few years. But the more gradually the taxes needed to replace oil revenue are phased-in, the less oil revenue can be saved in anticipation of it running low.

Another way to begin saving more for the future is by building on the Alaska model rather than reviving the income tax. Instead of replacing the saved oil revenue with income tax revenue, the state could replace it with taxes on other resources, including mining, fishing, forestry, the broadcast spectrum, financial services, land value, and so on.<sup>15</sup>

This tax strategy should appeal to Alaskans. They have already endorsed the principle of shared resource ownership as they have enthusiastically accepted their dividend checks over the past 30 years. If they endorse the principle that they should receive money for the resources others control, they should be amenable to paying others for the resources they control. Under such a system, the most significant new tax for typical Alaskans will be land value taxation, but one practical reason why the resource-tax strategy could be a good sell politically in Alaska is that, like ownership of oil leases, ownership of most other resources is also highly unequal and significantly held by people from out of the state. Many, if not most, ordinary Alaskans will come out ahead if additional resource taxation is used to boost the dividend.

As I have said in the earlier examples, I do not have the data to produce a reliable estimate about how much revenue could be generated from these sources. If we use my guess that other resources could produce half the revenue of oil, resource taxes could replace half of the oil revenue now going to the state budget. This strategy, therefore, could go a long way toward preparing the state for future reductions in oil revenue, and it could do even better if it were combined with some other form of tax.

Whatever strategy Alaskans employ to prepare for the day when oil revenue begins to decline, the best time to begin preparing is now. Oil exports will someday run low, and Alaska needs to be prepared.

#### NOTES

1. Widerquist, chapter 11, this volume.
2. Groh and Erickson 2012; Erickson and Groh 2012; Goldsmith 2012.
3. Hammond 1996.
4. The discussion here is similar to the idea that was discussed in Alaska at the time under the name, “the Cremo plan.” See Groh, this volume, XXX.
5. In July 24, 2011, the APF was \$41,224,000,000, according to the Alaska Permanent Fund Corporation 2011. This figure is in 2011 dollars; all other figures are in constant 2010 dollars.
6. Erickson and Groh 2012.
7. Widerquist and Howard 2012b, 118–119.
8. In Alaska, this sort of proposal is often referred to as the Cremo plan. See Groh and Erickson 2012, Chapter 2 in Widerquist and Howard 2012a.
9. Warnock 2006.
10. Warnock 2006.

11. See Flomenhoft in this volume.
12. Rose 2008, 210.
13. Erickson and Groh 2012.
14. Again, I am optimistically assuming stable population. Dividends would be smaller if the population rose.
15. See Flomenhoft's chapter in this volume for resource and common-assets taxes that could be employed.

## PART III

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A Hybrid Proposal with Commentary



Citizens' Capital Accounts:  
A Proposal

*Karl Widerquist*<sup>1</sup>

This chapter proposes a personalized version of Alaska's Permanent Fund (APF) and Permanent Fund Dividend (PFD) system, called "Citizens' Capital Accounts" (CCAs),<sup>2</sup> which will combine some of the benefits of basic income and stakeholder grants. CCAs make for a more flexible and meaningful use of revenue than an equal-sized basic income, resource dividend, or stakeholder grant.

The APF is one big, centralized fund. Its managers decide how much of the returns to distribute as dividends at a fixed time each year. Alaskans simply receive checks. The CCA system would personalize the fund by giving each individual an account within the larger fund. The account would accrue returns all the time, but within limits; individuals could decide when to withdraw their returns or whether to leave their returns in the account to accrue compound interest that they can draw on later.

Thus, at birth each child receives an account in a government held and managed fund of diversified investments such as stocks, bonds, real estate, and so forth. The account holder has access to the returns in her account but not the principal. Account holders could have some control over the principal, such as the right to direct investing some or all of their principal to one or more competing funds within the CCA-fund system.<sup>3</sup> But account holders cannot withdraw any part of the principal, because the principal does not belong to them as individuals; it belongs to the community and to future generations. A fixed amount of the returns must be reinvested. These mandatory

reinvestments become part of next year's principal to ensure that the principal increases every year. At death the entire principal (but not the available returns) is returned to the national fund to help finance the next generation's accounts. Available returns (including compound interest) left in the account become a part of the account holder's estate at death. Ideally, in a fully phased-in system, account holders would receive their principal in one lump sum grant at birth, and their account would grow only as the returns accrue. But it is equally possible for account holders to receive small yearly grants that are added to the principal—as the APF receives from new oil revenues. This chapter mainly discusses one lump sum at birth, but it also considers yearly additions to the principal.

CCAs combine some elements of basic income,<sup>4</sup> stakeholder grant<sup>5</sup> or baby bonds,<sup>6</sup> and Alaska's PFD.<sup>7</sup> Basic income distributes a uniform benefit to every citizen in cash on a regular basis (weekly or monthly). Most basic income proposals finance it out of current income tax revenue, but they could be financed by the returns on a fund like the PFD. Stakeholder grants give all citizens a lump sum when they reach a certain age. Ackerman and Alstott propose a grant of \$80,000 at age 21.

Like basic income, the returns of a CCA provide a small lifetime income, but unlike basic income, individuals have incentives to leave their returns in their account until they need it for a particular purpose. Like stakeholder grants, CCAs give individuals flexibility in how they use the money, but unlike stakeholder grants, CCAs also provide a small amount of continued economic security. The incentive the CCAs give for account holders to leave their returns in their accounts means that CCAs are likely to provide greater economic security than either an equal-sized basic income or an equal-sized stakeholder grant.

The rest of this chapter discusses CCAs in detail. Section one examines the specifics of how a CCA system would work. Section two discusses how CCAs can be financed and phased in. Section three discusses the pros and cons of CCAs. Section four concludes.

## 1. HOW CITIZENS' CAPITAL ACCOUNTS WORK

The most basic idea of a CCA system is that each individual has an account giving her claim to a portion of national wealth, allowing her to draw the returns but not the principal. It could have many



variations. A CCA System I am proposing here has the following features:

**At birth, each child receives an account with a certain amount of money called a “stake” or a “grant.”**

The stake could be awarded in a lump sum at birth or in small amounts each year.

**The account is held in a government-managed investment fund of stocks, real estate, bonds, and other financial assets.** The government can either manage the fund directly or allow competing, regulated companies to manage portions of it. In either case, some portion of the returns to the account would go toward the overhead cost of managing the assets in the system.

**The account returns are divided into two portions, “available returns” and “mandatory reinvestments.”** Available returns are the portion of the returns the owner is allowed to withdraw. Mandatory reinvestments are the portion of the returns the account holder must reinvest to ensure that the account grows over time. They include all purely nominal returns and one-third of the “real” (inflation adjusted) yearly returns. The account holder may leave her available returns in her account. They will continue to earn interest at the same rate as the principal, and they will continue to be available to her at any time. All of the compound returns on past available returns are also available returns. If the account owner chooses to withdraw her returns, she can take them at any rate she chooses, yearly, monthly, or even daily.

**“Principal” is defined as the initial stake, plus all mandatory reinvestments.** This definition is slightly different from the typical accounting definition of principal, but it is useful to use the term in this way, because it allows the total value of a CCA to be divided into two portions. Available returns, which account holders can withdraw, and principal, which they cannot.

**Accounts have a government insured minimum real return of 3 percent per year.** If the national fund succeeds in making more (over the insurance costs and management costs), the additional returns are added to individuals’ accounts. The insured minimum return is necessary for macroeconomic stabilization (see section three). The insurance can be financed by premiums taking a portion of returns above 3 percent in good years.

**Neither the CCA nor any of its future returns may be used as collateral for loans, and creditors cannot seize them in the event of bankruptcy.** The reason for this provision is that the primary goal of CCAs is to provide a minimum level of economic security. A balanced concern for opportunity is secondary. The returns in a CCA can only be taken involuntarily from the account holder by a legal judgment (such as for child support or damages).

**At death, the principal is returned to the fund for redistribution to the next generation.** Any remaining available balance can be inherited by the heirs of the account holder subject to the same taxes as all other inheritance and gifts.

**CCAs could be financed out of taxes on wealth, natural resources, inheritance, income, or other sources.** Although any type of tax could be used to finance CCAs, and arguments elsewhere in this book point out benefits of resource taxes, it is not the role of this chapter to discuss the best source of funding. The chapter uses wealth taxes as the primary example.

**The parent who has custody of a child can withdraw the child's available returns for the child's benefit.** Unless the parent is legally found to be neglectful (discussed below), the parent has the discretion to decide what is in the child's best interest subject to two restrictions: First, in the case of joint custody, both parents must agree to withdraw the child's returns. Second, parent(s) cannot withdraw a child's available returns unless the custodial parent(s)' returns have already been withdrawn.

**Immigrants receive a CCA when they become citizens.** Immigration slightly complicates the system, but for reasons of simplicity, I don't deal with that in this chapter.

For the primary example, I make the following assumptions: (1) CCAs begin with a \$50,000 grant at birth financed by a wealth tax. (2) No additions to principal are made by the government during a person's life. (3) CCAs make only the minimum return of 3 percent. (4) Mandatory reinvestments are one-third of total return for that year; that is, 1 percent, as long as the return remains 3 percent. There is (5) no immigration or emigration, (6) no inflation, and (7) no population growth or decline.

Assumptions 5–7 are for simplicity. The need for mandatory reinvestments is explained above. The assumption that they are set at one-third of total returns (assumption 4) is arbitrary. I assume a 3 percent

return (assumption 3) to be extremely conservative. Most investment advisors agree that it is safe to take 4–5 percent from an account each year and still expect it to grow in real terms. The Alaska Permanent Fund Corporation reports an average annual real return of about 6 percent, double what I am assuming. I make the assumption of no additions to principal (assumption 2) after the initial grant partly for simplicity. It focuses on changes in the size of the account caused by returns and withdrawals rather than by additional grants. I also make it partly to imagine a fully phased-in system in which all new revenue can be directed to the next generation.

The assumption of a \$50,000 grant financed by a wealth tax (assumption 1) needs a little more explanation. I chose a wealth tax partly for simplicity. It makes for easy calculations. But I also choose it for efficiency and equity. Although resource and rent taxes may be just as good or better, the wealth tax is hard to evade, and it might have a stimulating effect on the economy by giving wealth holders an incentive to keep their assets working. Wealth holding is extremely unequal, far more so than income. Yet, it represents a claim on preexisting property. Taxing it does not tax current productive activity but the value of all previously accumulated assets, including natural resources and the things we make out of them. Ed Wolff and others make persuasive arguments for a wealth tax.<sup>8</sup>

The net private wealth of the United States in 2009 was more than \$54 trillion. The population was about 308 million, and there were more than 4 million births.<sup>9</sup> A 2 percent wealth tax (with no exemptions) would raise \$1.08 trillion dollars—more than \$3,500 per person per year, or more than \$250,000 per live birth per year. That is enough for a substantial stake even if substantial exemptions cut into the wealth tax. A \$50,000 stake for each of the 4 million babies born in the United States each year would cost \$200 billion per year—roughly 0.4 percent of national wealth. Therefore, once a CCA system of that size is up and running, the yearly costs would be well within what could be financed by a small wealth tax with substantial exemptions (see section three for discussion of financing and phasing it in).

The \$50,000 figure is also useful for comparing the CCA system to the Alaska Dividend. If Alaska were to divide its \$40 billion permanent fund into a system of CCAs for each of the 700,000 Alaskans, each account would begin with approximately \$57,000.<sup>10</sup> Thus, the round figure of \$50,000 is roughly equivalent to the per capita value of the APF; it gives an idea of what size CCAs Alaskans could have right now.

Table 13.1 shows the lifetime account options provided by a CCA with a \$50,000 initial grant and a 3 percent return. Column 1 shows the “maximum balance” of an account owner who makes no withdrawals in her life. She begins with a balance of \$50,000 at birth. Her account grows steadily, doubling in about every 24 years. It reaches \$93,015 by her 21st birthday and \$532,045 by her 80th birthday.

Column 2 shows the “principal” or minimum balance. It is calculated as the initial stake plus the mandatory reinvestments (1 percent of principal each year). That is, it shows the amount that must be in everyone’s account each year, even if they withdraw all their available funds as they come in. The principal grows at only one-third the rate of the total balance, reaching \$61,620 by her 21st birthday and \$164,058 by her 80th birthday.

Column 3 shows the “available returns” of someone who hasn’t made any withdrawals up to that point. This is simply the maximum balance minus the principal. For example, someone who doesn’t make any withdrawals until age 21 can withdraw a lump sum of up to \$31,395. This is not a fortune, but it is a significant amount of money for someone in a financial crisis or who wants to start a family, to invest in education, or simply to take a year or two out of the labor force. It would provide a reasonable cushion in the event of unemployment or the inability to find an acceptable job. Anyone who withdrew her entire balance at age 21 would bring her balance down to the principal of \$61,620—the same as someone whose parents had made the maximum withdrawal every year throughout her childhood. The following year she would be able to withdraw only \$1,232 (column 4). If the account holder waited until age 30, she could withdraw \$53,971, more than enough to take a few years out to get a child through infancy or to start a business, travel, reenter education, and so on. A person who left her money in her account until age 60 would have available returns of \$203,745 for retirement. This table shows no available returns on the day of the child’s birth and \$1000 available on the first anniversary of her birth, but these returns actually become available gradually over the child’s first year of life.

Column 4 shows the minimum available returns each year or the basic income equivalent of the CCA. That is, the amount an account owner can withdraw each year, if she withdraws the maximum amount every year starting at birth. Someone who (along with her parents during childhood) chose to use her account this way would receive an extremely modest basic income starting at \$1,000 and rising extremely slowly, reaching only \$1,220 by age 21, and it will not reach \$2,000 until her 71st birthday.

**Table 13.1** A CCA with an initial grant of \$50,000 and 3 percent interest, to age 80

	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<i>Age</i>	<i>Maximum balance</i>	<i>Principal (minimum balance)</i>	<i>Maximum - available returns</i>	<i>Minimum available returns (BI equivalent)</i>
0	\$50,000	\$50,000	\$0	\$0
1	\$51,500	\$50,500	\$1,000	\$1,000
2	\$53,045	\$51,005	\$2,040	\$1,010
3	\$54,636	\$51,515	\$3,121	\$1,020
4	\$56,275	\$52,030	\$4,245	\$1,030
5	\$57,964	\$52,551	\$5,413	\$1,041
6	\$59,703	\$53,076	\$6,627	\$1,051
7	\$61,494	\$53,607	\$7,887	\$1,062
8	\$63,339	\$54,143	\$9,196	\$1,072
9	\$65,239	\$54,684	\$10,554	\$1,083
10	\$67,196	\$55,231	\$11,965	\$1,094
11	\$69,212	\$55,783	\$13,428	\$1,105
12	\$71,288	\$56,341	\$14,947	\$1,116
13	\$73,427	\$56,905	\$16,522	\$1,127
14	\$75,629	\$57,474	\$18,156	\$1,138
15	\$77,898	\$58,048	\$19,850	\$1,149
16	\$80,235	\$58,629	\$21,606	\$1,161
17	\$82,642	\$59,215	\$23,427	\$1,173
18	\$85,122	\$59,807	\$25,314	\$1,184
19	\$87,675	\$60,405	\$27,270	\$1,196
20	\$90,306	\$61,010	\$29,296	\$1,208
21	\$93,015	\$61,620	\$31,395	\$1,220
22	\$95,805	\$62,236	\$33,569	\$1,232
23	\$98,679	\$62,858	\$35,821	\$1,245
24	\$101,640	\$63,487	\$38,153	\$1,257
25	\$104,689	\$64,122	\$40,567	\$1,270
26	\$107,830	\$64,763	\$43,067	\$1,282
27	\$111,064	\$65,410	\$45,654	\$1,295
28	\$114,396	\$66,065	\$48,332	\$1,308
29	\$117,828	\$66,725	\$51,103	\$1,321
30	\$121,363	\$67,392	\$53,971	\$1,335
31	\$125,004	\$68,066	\$56,938	\$1,348
32	\$128,754	\$68,747	\$60,007	\$1,361
33	\$132,617	\$69,435	\$63,182	\$1,375
34	\$136,595	\$70,129	\$66,466	\$1,389
35	\$140,693	\$70,830	\$69,863	\$1,403
36	\$144,914	\$71,538	\$73,375	\$1,417
37	\$149,261	\$72,254	\$77,008	\$1,431
38	\$153,739	\$72,976	\$80,763	\$1,445
39	\$158,351	\$73,706	\$84,645	\$1,460
40	\$163,102	\$74,443	\$88,659	\$1,474
41	\$167,995	\$75,188	\$92,807	\$1,489
42	\$173,035	\$75,939	\$97,095	\$1,504

**Table 13.1** Continued

43	\$178,226	\$76,699	\$101,527	\$1,519
44	\$183,573	\$77,466	\$106,107	\$1,534
45	\$189,080	\$78,241	\$110,839	\$1,549
46	\$194,752	\$79,023	\$115,729	\$1,565
47	\$200,595	\$79,813	\$120,782	\$1,580
48	\$206,613	\$80,611	\$126,001	\$1,596
49	\$212,811	\$81,417	\$131,394	\$1,612
50	\$219,195	\$82,232	\$136,964	\$1,628
51	\$225,771	\$83,054	\$142,717	\$1,645
52	\$232,544	\$83,884	\$148,660	\$1,661
53	\$239,521	\$84,723	\$154,797	\$1,678
54	\$246,706	\$85,571	\$161,136	\$1,694
55	\$254,107	\$86,426	\$167,681	\$1,711
56	\$261,731	\$87,290	\$174,440	\$1,729
57	\$269,583	\$88,163	\$181,419	\$1,746
58	\$277,670	\$89,045	\$188,625	\$1,763
59	\$286,000	\$89,935	\$196,065	\$1,781
60	\$294,580	\$90,835	\$203,745	\$1,799
61	\$303,418	\$91,743	\$211,674	\$1,817
62	\$312,520	\$92,661	\$219,859	\$1,835
63	\$321,896	\$93,587	\$228,308	\$1,853
64	\$331,553	\$94,523	\$237,029	\$1,872
65	\$341,499	\$95,468	\$246,031	\$1,890
66	\$351,744	\$96,423	\$255,321	\$1,909
67	\$362,296	\$97,387	\$264,909	\$1,928
68	\$373,165	\$98,361	\$274,804	\$1,948
69	\$384,360	\$99,345	\$285,016	\$1,967
70	\$395,891	\$100,338	\$295,553	\$1,987
71	\$407,768	\$101,342	\$306,426	\$2,007
72	\$420,001	\$102,355	\$317,646	\$2,027
73	\$432,601	\$103,379	\$329,222	\$2,047
74	\$445,579	\$104,412	\$341,167	\$2,068
75	\$458,946	\$105,456	\$353,490	\$2,088
76	\$472,715	\$106,511	\$366,204	\$2,109
77	\$486,896	\$107,576	\$379,320	\$2,130
78	\$501,503	\$108,652	\$392,851	\$2,152
79	\$516,548	\$109,738	\$406,810	\$2,173
80	\$532,045	\$110,836	\$421,209	\$2,195

Column 1: \$50,000 plus 3 percent interest each year.

Column 2: \$50,000 plus 1 percent interest each year.

Column 3: Total Balance minus Principal.

Column 4: Previous year's principal times 2 percent.

From table 13.1 we see that a CCA with an initial grant of \$50,000 and a 3 percent return could not finance a generous basic income, but it could provide a substantial rainy-day fund for anyone who saves it for when he or she needs it. The modest basic income equivalent follows largely from the conservative assumption about the size of the returns. If we assume a 6 percent average return, a \$50,000 initial stake produces a \$2,000 basic income equivalent at birth, reaching \$3,000 at age 22 and \$5,000 at age 48. At those interest rates, savers would accumulate more than \$1 million for retirement before they reached their 60th birthday. I haven't displayed tables showing such profiles, because I don't want to base the case for CCAs on any more than the most conservative assumptions about the rate of returns.

A larger stake could greatly increase a CCA's impact on financial security. Consider a CCAs system that could be financed by a 1 percent wealth tax with no exemptions (or a 2 percent wealth tax in which half of potential revenue is lost to exemptions and overhead costs). Such a tax would produce \$540 billion in revenue per year, or \$125,000 for each newborn child. Table 13.2 shows the account profile for selected years of a CCA of this size. It shows that minimum available returns begin at \$2,500 a year and rise to \$4,000 per year by age 50.

Column 1: \$125,000 plus 3 percent interest each year.

Column 2: \$125,000 plus 1 percent interest each year.

Column 3: Total Balance minus Principal.

Column 4: Previous year's principal times 2 percent.

Higher returns with an initial stake this size would make for a substantial amount of economic security. A return of 6 percent would

**Table 13.2** A CCA with an initial grant of \$125,000 and 3 percent interest, selected years

	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<i>Age</i>	<i>Maximum balance</i>	<i>Principal (minimum balance)</i>	<i>Maximum available returns</i>	<i>Minimum available returns (BI equivalent)</i>
0	\$125,000	\$125,000	\$0	\$0
1	\$128,750	\$126,250	\$2,500	\$2,500
10	\$167,990	\$138,078	\$29,912	\$2,734
20	\$225,764	\$152,524	\$73,240	\$3,020
30	\$303,408	\$168,481	\$134,927	\$3,336
40	\$407,755	\$186,108	\$221,647	\$3,685
50	\$547,988	\$205,579	\$342,409	\$4,071
60	\$736,450	\$227,087	\$509,363	\$4,497

double minimum available returns in the first year to \$5,000 and they would rise to \$10,000 by about age 36 even if the account holder spent all her available returns. At this point it begins to approach the size necessary to cover an individual's basic needs.

In the absence of a larger initial stake or higher returns, CCAs have two important uses. First, an additional income of \$1,000 to \$2,000 per year is a substantial income supplement, which could make an important difference for the working poor. Second, CCAs (at this level) can probably have their most important effects as a rainy-day fund. For example, notice (in table 13.1) that the available returns of someone aged 25 (who has made no withdrawals to that point) are more than \$40,000, and that the amount rises to nearly \$70,000 by age 35. A family of two would have access to more than \$80,000 at age 25 or nearly \$140,000 at age 35. This is more than enough money to weather a significant financial crisis. Someone could live off this amount of money for several years if they had to. Many people would probably use this money as a down payment on a home or as income replacement during a substantial parental leave. If they do, it won't be available as a rainy-day fund, and therefore we cannot think of CCAs as a replacement for the welfare system or for a comprehensive health care system, although it can reduce substantially the cost of welfare and the need for people to rely on the welfare system. CCAs are structured in a way to increase people's economic security, but the program lets people assess their own needs. It gives people greater options, and using it for one option necessarily precludes using it for other options.

Consider someone who withdraws her entire balance once every ten years until age 50. She (or more correctly her parents) can withdraw nearly \$12,000 at age ten. She can then withdraw \$13,000 at age 20, \$14,000 at 30, \$16,000 at age 40, and \$17,000 at age 50. The poverty threshold for a single person in 2009 was \$10,830, and nearly 40 million Americans lived in poverty at the height of the 2009 recession. Thus, even the small yearly income allows people the flexibility to live at an above-poverty standard without working one out of every ten years. The option does not enable people to live permanently without working, but it better enables them to do so for limited periods of time, whether by choice or by necessity.

The money is available whether the account holder needs to draw on it, or simply wants to. Of course, a CCA of this size does not provide as much flexibility and security as a basic income of \$10,000, but it provides much more security than she could get from an *equal-size* basic income. Without the protected savings opportunity, and the



default of leaving the money in the account until the holder taxes it out, a basic income of \$1,000 or \$2,000 per year gives people very little ability to weather an unexpected financial crisis.

## 2. WHY CITIZENS' CAPITAL ACCOUNTS

This section discusses the merits of CCAs. Most of the section evaluates CCAs relative to basic income and stakeholder grants, because I see CCAs as something in between those two proposals. However, this section addresses other concerns as well.

The main goal of the CCA system is to provide a method of sharing part of society's wealth with all people in a way that lets individuals judge their own needs. Some of the case for this has come out in the explanations above. Rather than passively receiving a check, as people eligible for the Alaska Dividend do, account holders in a CCA system decide when they want to take a dividend and when they'd prefer to let the returns accumulate for later.

Because people have an incentive to let their returns accumulate, CCAs can provide more economic security than an equal-sized basic income or resource dividend. Even at a low level discussed above (equivalent to a basic income of only \$1,000 per year), they provide a small income supplement for some, a periodic lump sum for others, or a safe retirement savings account for yet others. Of course, those most in need will have to draw on their yearly returns, and will not have a large lump sum available for a financial crisis, and therefore CCAs cannot be much of a replacement for the welfare system at this level, but they can do some of what a means-tested redistribution scheme can do with much less overhead. And CCAs can do one thing that the welfare system does not do: provide funds to be used for any sort of need whether or not it fits a need anticipated by the welfare system. The larger the account the more opportunity it gives people to use some of it as an income supplement, some for a sudden crisis, and some for retirement savings.

Basic income supporters might ask: why is it necessary for people to receive the additional incentive of interest on their unspent BI, when BI is structured so that people who earn more receive more (net of taxes and transfers)? One answer is that it gives the CCA system more popular appeal: it is more truly universal with tangible benefits reaching higher up the income spectrum. CCAs give the middle class options when they are young that they would not otherwise have and reward those who can afford to save their returns, with compound interest. Very few people can draw \$40,000 out of their savings at age

30, but CCAs would make that possible for anyone who managed not to draw on their account up to that point. Although basic income is universal in the sense that it pays a benefit to everyone, someone who pays \$20,000 per year in income taxes and receives a \$5,000 basic income may not feel that she benefits from this universality. She may surmise that if the basic income were cancelled her taxes would go down by at least \$5,000 and possibly much more. She may feel that she cannot really benefit from the basic income unless she quits earning income, and if she doesn't find that possible, she may feel that she's paying for privileges that someone else can take advantage of and she cannot. However, a CCA would give her a growing account financed out of the wealth of society that existed when she was born. If she does not need the money right now, it stays in her account and rewards her with more in the future. There is something in it for her and little in it for her to resent in others.

Looking ahead from birth, withdrawal patterns of a spender (who takes the maximum withdrawal every year) and a saver (who doesn't make any withdrawals until age 65) have equal present value, but looking back at age 65, they are very different. The spender receives a total of \$90,937 over 65 years. The saver would have access to a lump sum of \$246,031 at age 65. That is, her lifetime return would be about \$155,000 more than the spender's—well more than twice as much. And the lump sum has available more than 120 times the \$1,890 the spender has access to at age 65. Therefore, the saver has a powerful reason to support the program and no reason to resent those who choose to spend their entire balance each year. It is hard to believe that CCAs would involve any kind of stigma. No matter how account holders spend their returns, it seems unlikely that they will be viewed as “recipients” or anything but “owners” who exercise one of their many options for the use of their property. CCAs meet the conditions that I've discussed elsewhere in this book for attracting growing support. If they prove popular, there will be support for allowing the system to grow to the point at which the account alone would be large enough to meet a person's most basic needs.

One might argue that if wealthier people make fewer withdrawals, CCAs distribute more money to those already well off, and a smaller, targeted system could have the same impact on poverty while costing less. This argument is reasonable, but the larger returns available to someone who does not use them earlier in life come entirely from interest, not from tax revenues. The tax revenues that support CCAs are distributed equally to everyone, and the added benefits of

interest are necessary to achieve the universalizing effects discussed above. Despite the effects of compound interest, the CCA system would have a substantial equalizing effect on income and wealth, and many of those who will get the highest returns from their CCAs are likely to be the people who pay most of the taxes that support the program. It is possible to subject either withdrawals or returns to income tax, which would also increase the equalizing effect. But it is important to remember that any program that taxes property and distributes the proceeds equally is *progressive*. If the goal is to make the system more progressive, it can be achieved by creating a larger CCA system.

The CCA funding system weakens the “exploitation argument” used by critics of basic income, because it does not redistribute income from current workers to nonworkers. Instead, it redistributes a portion of existing wealth equally to everyone in the current generation. For a worker to claim exploitation under this system, she would have to claim that if the system were not in place she would have been able to appropriate more of the wealth that existed at her birth than she has in her CCA, and that this appropriation of wealth represents the just return to her labor. That is a very difficult case to make.

One advantage of CCAs is that—unlike stakeholder grants—they actually redistributed wealth as wealth. Guy Standing<sup>11</sup> criticizes stakeholder grants for being less of a true “stake” and more of a “coming of age grant” or “COAG.” Recipients *could* use their \$80,000 COAG to purchase a stake in our national wealth, but it *is* simply a temporary income. Many will spend it, blow it, be swindled out of it, or lose it in legitimate but unsuccessful investment before it does them any real good. A grant of even \$80,000 can be trivial once it is spent or lost, and it is hard to see a pressing need for a program that might have trivial effects on a large portion of the intended beneficiaries. One cannot lose the principal of a CCA and one can only lose the returns a piece at a time, each providing a potential lesson in how to manage future returns. By focusing on financial security rather than a onetime, fragile opportunity, CCAs address a more important need than stakeholder grants.

One might argue that CCAs are simply stakeholder grants with paternalistic restrictions added. Stakeholders could invest their grants in safe accounts and reap the benefits claimed for CCAs, if they believe that is the best use for their money. I will argue that to a small extent this perception is true, but the restrictions are necessary, and to a great extent this perception is false. This perception is true only

to the extent that it is impossible to enhance lifetime security without restricting people from borrowing against that future security or somehow converting those benefits into cash. If this is paternalism, CCAs have one small restriction that is paternalistic. However, even Ackerman and Alstott<sup>12</sup> admit that stakeholder grants of any size cannot be a substitute for the current welfare system, which has many paternalistic restrictions that CCAs do not have. Therefore, the entire redistributive system they advocate is paternalistic when taken as a whole, and probably more paternalistic than either basic income or CCAs would be if they were large enough to replace substantial parts of the welfare system.

Even so, I am not sure that “paternalistic” is the right word for the restriction on borrowing against future returns. Consider this example. You have a contract with a health insurer. You are eligible for a procedure that costs \$10,000, but you decide that you would rather have the cash. Is the health insurer necessarily being “paternalistic” if it refuses to give you the cash? I don’t believe so. The insurer’s refusal might be motivated by a concern for your well-being, but it might simply be motivated by the belief that it only owes you health care. If you don’t want the health care, it doesn’t owe you money to pursue other opportunities. I believe that society owes individuals some amount of economic security and that this duty takes precedence over a duty to provide less important kinds of economic opportunity.<sup>13</sup> If so, allowing individuals to trade economic security for opportunity is failing to provide what is owed.

Another feature of CCAs that might be interpreted as paternalistic is the protection of returns—insured against recessions and protected against creditors. But I do not believe this feature is paternalistic at all, because CCAs offer a desirable option that is otherwise unavailable. Any diversified investor might like to have some money in a financial asset as safe as CCAs, protecting them from creditors in the event of bankruptcy. It is quite possible that investment advisors would recommend keeping the maximum balance in CCAs.

The largest restriction on CCAs is the rule prohibiting account holders from spending the principal. A restriction like this could exist for paternalistic reasons, but it exists in this proposal not for paternalistic reasons but because at death the principal no longer belongs to the deceased but to the next generation. Ackerman and Alstott rely on repayment at death for future funding of stakeholder grants, but they have no penalty for those who do not repay their

stakes, and so we can expect limited compliance. Prohibiting spending the principal ensures perfect compliance with the payback rule. Although this restriction might have effects that could benefit the account holder, its main function is not to protect the account holder from herself but to protect future generations from the account holder.

The common definition of most forms of property awards the owner a perpetual license to do with it as she pleases with it. She can save it and pass it down to her heirs until the end of time or she can convert it into bananas and let it rot overnight. This view of the right to property has some merit if the owner created the property entirely out of her own efforts and if the property would not have existed if it were not for her. But most of our property is made out of natural resources that belong to all of us as much as to any of us, and to future generations as much as to our generation.<sup>14</sup> Your CCA is not your creation; it is your share of the stock of resources and capital that existed when you were born. You are entitled to a share of this wealth, but not as a perpetual owner, only as a custodian who has title to its returns while living but who must maintain the principal and return it to future generations at the end of life.

CCAs, by widening the population that receives inheritance, represent a fresh challenge to the notion that the acceptance of benefits requires a reciprocal obligation. CCAs do not ask the workers to share with the needy; they ask that some portion of existing preexisting wealth should be shared with everyone. For those who are concerned with the right to accumulation of an inheritance, a 1 percent or 2 percent wealth tax in any economy where wealth tends to return far more each year does not greatly restrict the freedom of the wealthy to accumulate and perpetuate wealth, and it provides an important opportunity for everyone else to begin to do the same.

CCAs would have a desirable macroeconomic effect on both the supply and demand side. On the demand side, they would act as an automatic stabilizer in several ways. First, people will withdraw and spend more of the returns from their accounts during recessions, helping to maintain aggregate demand. Second, the insured returns of CCAs guarantee that some portion of every citizen's wealth will be stable during the ups and downs of the business cycle, decreasing the negative wealth and income effects that sagging markets have on aggregate demand. Third, CCAs provide an effective and equitable way to stimulate the economy and inject support into the financial system during a crisis. Instead of bailing

out big banks, the central bank could buy financial assets and place them in CCAs.

On the supply side, one concern about redistribution from the rich to the poor is that it takes from those who are most likely to save and invest their income and gives to those who are least likely to do so, possibly slowing the increase in the capital stock and decelerating economic growth. CCAs do not redistribute income; they redistribute wealth as wealth—without allowing the beneficiaries to convert that wealth (the principal) into income. The principal in a CCA is so large compared to most people's stock of saving, that even if it partly crowds out private savings, it will lead to a substantial increase in the average savings rate, which will hopefully translate into an increase in investment and higher growth.<sup>15</sup> A greater concern with CCAs might be whether they encourage too much savings.

One might criticize the discretion CCAs give parents to withdraw their children's returns, because a few parents will spend their children's wealth on their own consumption, and the children of such parents will have to endure a reduced financial position in adulthood. There are several reasons why this possibility does not mean that we should deny all parents the option of withdrawing a child's returns for the child's benefit. First, child poverty is probably the largest economic problem in the United States. Many families live at the margins of poverty or below, and in such cases, the child would be much better-off being slightly less poor in childhood than having a large lump sum of cash at age 21. Good parents who are struggling financially need this option. Second, most parents are good parents. Most parents will spend their own returns on their children rather than the reverse. The legal system, which already holds parents to the obligation to meet their children's needs, has not found it beneficial to supervise the spending habits of all parents to preempt the actions of the few who put their own consumption ahead of their children's needs. It has proven much more effective to allow discretion to all parents and to prosecute the few who misuse it. This basic strategy should not change when CCAs are introduced. Third, for those children whose parents do get away with misspending their returns, no lump sum of money at age 21 will make up for that childhood, and it is unlikely that making a neglectful parent poorer (by \$1,000 per year) will make that parent less neglectful, or that childhood any more bearable.

CCAs could be criticized for not distinguishing between the needy and advantaged or between the deserving and the undeserving. With CCAs in place, people who are lucky enough to have a good job and no major financial crises in life can retire with a large amount

of money; people who draw down their balance will retire with less, regardless of why they did so—regardless of whether they needed to or simply wanted to make withdrawals. Refer back to table 13.1 and compare the accounts of several different people. George, who is of below-average ability, gets a series of great jobs thanks to his parents' connections. He doesn't make any withdrawals from his CCA until he retires at age 60 and withdraws his entire balance of \$203,745 to enjoy as a supplement to his other retirement assets.

Consider several other people, all of whom withdraw \$10,000 per year for four years beginning at age 28. This decision reduces their available returns from over \$45,000 at age 27 to barely more than \$15,000 by the time they stop making withdrawals at age 32, when their balance begins to grow again. They will have an available balance of \$105,155 at age 60. Their decision to withdraw \$40,000 between the ages of 28 and 32 costs them an additional \$65,155 in lost returns by the time they reach 60. George has nearly double what they have in available returns at 60. Imagine that all of these people make withdrawals for the following different reasons:

Pat's partner dies in childbirth. The withdrawals pay for daycare.

Fran chooses to become a single parent and to leave the labor force, living entirely off the returns and very close to poverty for four years.

Barbara is laid off from her job, spends 18 months trying to find a similar job before she gives up and spends two years in retraining.

Kate chooses to leave the labor force and spend several years traveling cheaply.

Joy uses the money to help start a business, and she eventually becomes fabulously wealthy.

Joe uses the money to help start a business, which fails.

Bill takes time off to write the greatest novel of the Twenty-first Century.

Jill takes time off to write a bad novel that no one would willingly finish.

Jack is just a lazy guy who wants to experience a four-year vacation getting drunk.

Allison suffers from undiagnosed clinical depression; she can't hold a job and drinks a lot, until she finds help.

Although some of the people in this group strike me as more needy or more deserving than others, I would not want to judge them.

Treating them all the same may not fully achieve all the ideals of justice, but I would not want to sit in a committee charged with determining the exact amount that each of them justly deserves. CCAs do not anticipate all the needs people might have, and so they cannot replace the entire welfare system. They do not create the perfectly just society, they simply embody the adage “rich or poor, it’s good to have money.” In that way they combine a commitment to universality with respect for diversity.<sup>16</sup> A wealthy person who divides her estate equally among her children runs the risk that some will face misfortune and others not, that some will use it wisely and others not. She can only hope that the stake she leaves her children is enough to help them through whatever circumstances they might face. An inherent feature of property is that if you save, it grows, but if you spend, it disappears (regardless of why you spend it). CCAs are not designed to change the nature of property, but to address the biggest problem with property—that some people have none. A society with CCAs is simply capitalism in which everyone has a minimum piece of ownership. It is not utopia, but it can help people through the greatest financial risks of capitalism.

### 3. FINANCING AND PHASING-IN A CCA SYSTEM

After a CCA system has been in place for generations, it will be substantially self-sustaining. The principal returned at death will provide the initial stake for most newborn citizens, and the system will run on the returns to capital. But the same feature that makes the system largely self-sustaining in the long run makes it tricky to get started in the short run. Accounts need a large amount of principal before they can produce significant returns. This fact presents three options for phasing it in: (1) start with high but temporary taxes; (2) start with a small group of people, such as newborns; (3) start with small accounts and gradually increase them over time.

This is what philosophers call a trilemma. This trilemma is the reason that sovereign wealth funds, such as the APF, currently exist almost exclusively in places that have had substantial resource windfalls. Such windfalls provide the opportunity for large, temporary taxation and a good reason to save some of that windfall and spend only the returns. I have argued elsewhere in this book that resource windfalls happen much more often than we realize; we usually let them pass without taking advantage of them. But as has also been



argued elsewhere in this book, a resource windfall is not the only way to create a dividend-paying wealth fund. So, I'll focus on opportunities to create a fund without high temporary taxes.

As I said above, a \$50,000 stake for each baby born in the United States each year would cost \$200 billion per year and could be financed by a small wealth tax. But, of course, if we started it only with the babies born this year, more than 35 years would pass before half of the population had a CCA, and the equity problem between a child born this year and one born last year would be substantial. Therefore, although it would be an affordable way to create sizeable CCAs for our children, a generational phase-in would not be the best way to begin.

The third option is to begin with small accounts, gradually increasing them over time. Table 13.3 shows how to do so with tax revenue the same size as shown in table 13.2: \$540 billion per year—1 percent of national wealth. With a population of 308 million, that revenue provides a grant of about \$1,775 per person per year.

Table 13.3 shows the first 40 years of an individual CCA profile based on these assumptions. The columns have the same definitions as in table 13.1. A minimum interest rate of 3 percent and mandatory reinvestments of one-third of yearly returns would produce first year available returns of only \$35. But the principal would grow each year not only with mandatory reinvestments but also with new additions of \$1,775 to the principal from each year's tax revenue. Therefore, returns would grow much faster over time than in the original example. If left in the account, maximum available returns grow to nearly \$10,000 by age 20 and \$50,000 by age 40. If withdrawn each year as a basic income, the minimum available balance grows to \$1,000 by the account holder's late 20s and \$2,000 by the account holder's mid 40s.

Thus, even assuming an interest rate of only 3 percent, in a few decades, CCAs will have grown to the point at which they would significantly improve financial security for everyone. Even if new tax revenue were then redirected to newborns, CCAs would continue to grow and to become more significant over time for everyone. There may be good reason to redirect most new revenue to newborns at some point. The way CCAs allow individuals to take advantage of accumulated net interest confers a large part of the benefits of the program on them later in their lives. But most people in the United States face their greatest financial insecurity earlier in their lives.

**Table 13.3** CCAs supported by \$1,775 yearly grants, selected years

	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
<i>Age</i>	<i>Maximum balance</i>	<i>Principal - (minimum balance)</i>	<i>Maximum - available returns</i>	<i>Minimum available returns (BI equivalent)</i>
0	\$1,755	\$1,755	\$0	\$0
1	\$3,583	\$3,548	\$35	\$35
10	\$22,707	\$20,509	\$2,198	\$371
20	\$50,865	\$41,225	\$9,639	\$781
30	\$88,706	\$64,109	\$24,598	\$1,234
40	\$139,562	\$89,386	\$50,176	\$1,735
50	\$207,908	\$117,308	\$90,600	\$2,288
60	\$299,760	\$148,152	\$151,608	\$2,899

- Column 1: \$1,775 plus 3 percent interest each year, plus additional yearly grants of \$1,775.
- Column 2: \$1,775 plus 1 percent interest each year, plus additional yearly grants of \$1,775.
- Column 3: Total balance minus principal.
- Column 4: Previous year's principal times 2 percent.

#### 4. CONCLUSION

CCAs, especially if they start small, are not meant to replace other redistributive programs. Like the Alaska Fund, their purpose is not to revamp the welfare system but to provide everyone with a share in the ownership of our nation. They will not make our society perfectly just or eliminate all of our economic problems, but by ensuring everyone a small minimum share of the wealth of our nation, they will reduce our economic problems and make our society significantly more just.

#### NOTES

1. This idea grew out of many discussions over a long period of time. Thanks to everyone who participated in those discussions. I can't remember everyone, but I will make sure to name Michael Howard, Erik Wright, Anne Alstott, Philippe Van Parijs, Bruce Ackerman, Michael Lewis, Julian Le Grand, Hillary Silver, Diego Hernandez, and Alan Halfpenny.
2. The singular form of "Citizens' Capital Accounts" (CCAs) is "Citizen's Capital Account" (CCA). I use them both almost exclusively in abbreviation.

3. I will not discuss whether it is best to allow account holders to have control over the principal. If they were allowed to, it would have to be regulated and limited to avoid risks, especially if returns are insured.
4. Van Parijs 1995; Fitzpatrick 1999; Van Parijs 2001; Standing 2002.
5. Ackerman and Alstott 1999; Ackerman and Alstott 2006.
6. Le Grand 2006.
7. Goldsmith 2002.
8. Wolff 1995; Shapiro and Wolff 2001; Wolff and Leone 2002.
9. US Census Bureau 2011.
10. According to the APFC website, the APF was at \$41.08 billion on July 10, 2011.
11. Standing 2006.
12. Ackerman and Alstott 1999.
13. This article is not the place to argue this point, but I have argued it elsewhere, including Widerquist 1999 and 2010.
14. See Ian Carter 2012.
15. Precautions should be taken to ensure that the increase in savings is not too large.
16. Williams 1999.



A Jubilee Tax for Citizens'  
Capital Accounts

*Michael W. Howard*

Karl Widerquist's proposal for Citizens' Capital Accounts (CCAs) is bold and timely. Given the times we live in, I'd like to encourage us to think even more boldly. Widerquist proposes to fund CCAs through a 2 percent wealth tax, or 1 percent for a gradual phase-in. This would create an endowment per capita for the United States comparable to the per capita endowment of the Alaska Permanent Fund (APF). But why not aim higher? If a 2 percent wealth tax will yield about \$3,500 per person, why not have a onetime "jubilee" wealth tax of 29 percent,<sup>1</sup> and create a \$50,000 endowment for everyone, and then fund the endowments for newborns with the 0.4 percent annual wealth tax until the system became self-sustaining?

If such a large tax seems outrageous, consider that over the past 30 years there has been a massive shift of wealth from the poor and middle class to the upper 20 percent, and especially the top 1 percent. In 2009, the share of private wealth owned by the top 20 percent had risen to 87.7 percent, and that of the top 1 percent to 37.1 percent.<sup>2</sup> A onetime jubilee tax would fall disproportionately on the top 20 percent, and within that group, on the top 1 percent. This is precisely the group that has gained economically over the past 30 years, while middle class and poor people's share of the wealth has decreased, their incomes have fallen or stagnated, and their debts have risen. Such a tax would solve the problem of transition by seizing the first option, high, but temporary, taxes. These taxes, however, would be borne mostly by the affluent and wealthy, and most citizens would

experience a net gain. This runs the risk of creating opposition from the top 20 percent. But the gradual phase-in risks loss of support from others because the benefit is too meager. The phase-in, with contributions to principal of \$1,775 from a 1 percent wealth tax, will give a 40-year-old person only \$24,598 at age 70, or a basic income at that age of \$1,234. Those are not insignificant, but they are low enough and distant enough to dampen enthusiasm in the middle to upper age groups. The burden of a jubilee tax on the less affluent among the top 20 percent could be eased by graduating the tax, so those in the top 10 percent and top 1 percent would pay higher rates, and those in lower brackets would pay lower. At a moment when, thanks to the Occupy movement, wealth inequality is in the national conversation, why not link a proposal for CCAs with measures that will make a real dent in that inequality?<sup>3</sup>

CCAs are also a way of realizing a couple of ideas suggested in John Rawls's theory of justice. Rawls argues that free and equal citizens, if they were to choose the principles of justice to govern the basic institutional framework of society, would support a secure scheme of basic liberties, equality of opportunity, and distribution of wealth and income according to the "difference principle."<sup>4</sup> The difference principle stipulates that inequalities are justified only if they are to the advantage of the least advantaged. When discussing institutional alternatives, ranging from laissez-faire capitalism to centralized state socialism, Rawls argues that the difference principle (together with basic liberties) could best be realized by either liberal socialism or a "property-owning democracy."<sup>5</sup> I'll focus on the latter since it is more reachable from where we are, and CCAs fit very well with the concept, but liberal socialism could incorporate CCAs as well.<sup>6</sup> A property-owning democracy is best understood by distinguishing it from welfare state capitalism. In the latter, inequalities are allowed to grow enormously, but periodically some redistribution ensures that the losers in the game are kept from falling below a minimum. At first glance, this might appear to be what the difference principle requires. But such a society is not compatible with equal basic liberties and the value thereof: a relatively small elite exercises disproportionate influence in politics and in the economy. Nor does it honor reciprocity, a basic norm of justice at the heart of Rawls's conception, because in such a winner-take-all society, with crumbs for the losers, the most advantaged group gains at the expense of the least advantaged group. Reciprocity requires that participants in a system of social cooperation should all benefit from their shared activity, and no one should gain more only by others having less. This does not rule out inequality.

In fact, incentives for development of skills or investment of personal wealth, which result in greater aggregate production, are to the advantage of the least advantaged as well as to the advantage of those who are incentivized, if all share in the increased wealth. But true reciprocity requires that the gains of some in their overall life prospects should not come about by losses for others.<sup>7</sup> Property-owning democracy, in contrast with the welfare state, seeks to assure a wide distribution of wealth and talents *ex ante*, so there does not have to be redistribution of income appropriated because of a prior imbalance of power and wealth. A wide dispersal of developed talents can be promoted through public education. The dispersal of wealth could be done in a variety of ways. Some have advocated converting capitalist enterprises into cooperatives.<sup>8</sup> Others have proposed nationalizing the stock market and distributing shares equally to all, in a scheme that would prevent reconcentration of ownership over time.<sup>9</sup> CCAs offer another way to establish a broader ownership of capital wealth that will insure this dispersal over time. The wealth tax will take some significant amount of capital from the relatively privileged and distribute it equally to all. The steeper the wealth tax, the more this will be achieved. The requirement that the principal be untouched and passed on to the next generation insures that the dispersal over the entire population will persist through time. At whatever level CCAs are funded, they are a step toward a property-owning democracy.

Some may fear that the productivity of our economy would be threatened by such a measure. This fear is certainly groundless if we are contemplating a wealth tax of 1 or 2 percent. But even the bolder jubilee tax I have suggested need not affect the daily functioning of our market economy. The managers of publicly traded companies would still seek to maximize profits for the shareholders. They would scarcely notice that the faces of the shareholders had changed. This is one implication of Widerquist's remark that CCAs redistribute "wealth as wealth." There is no danger of decapitalizing the economy by liquidating assets and handing out cash. People who work for wages and salaries will continue to receive that income for their contributions. All that changes is who receives the dividends from ownership. Some wealthy people will receive somewhat less, yet remain wealthy. On the other hand, freed from economic insecurity, and in possession of productive resources, the owners of CCAs will be much better equipped to make productive contributions to society.

Reciprocity is an exacting norm of justice. For a society to achieve it with CCAs, in conjunction with other institutions, a more far-reaching redistribution of wealth would be required than would

happen with a 2 percent wealth tax. But CCAs are flexible and could be expanded to meet egalitarian goals. Is it unrealistic to hope for a convergence of demands from the street and the requirements of ideal theory?

#### NOTES

1. The term “jubilee” comes from Leviticus 25:1–14, and refers to a just redistribution of the wealth every 50 years.
2. Wolff 2010.
3. Another way to generate some CCA endowments for all, which responds to the current debt crisis, is a debt jubilee, forgiving debts by injecting fiat money into accounts for all citizens. These funds would be used to ease debts, and for those not in debt, it would constitute a cash grant. See Keen 2012.
4. Rawls 1999 and 2001.
5. Rawls 1999, xv; Rawls 2001, 135—40, 158—62.
6. Howard 2000, 151—81.
7. Rawls 2001, 61—66, 74—77.
8. Howard 2000; Schweickart 1994.
9. Roemer 1994; Howard 2000, 152—55.



Widerquist on Citizens'  
Capital Accounts

*Jason Berntsen*

INTRODUCTION

Opponents to Widerquist's proposed system of Citizens' Capital Accounts (CCAs) will fall naturally into two categories. Some will oppose it simply on the grounds that it would be a large government program designed to redistribute resources from the rich to the poor. This category of opponent divides naturally into two sub-categories: those who regard government redistribution programs backed by coercive taxation as morally objectionable in principle, and those who think that even if such government programs are in principle justifiable, they tend not to work, and tend, in fact, to have seriously bad unintended consequences. In contrast, opponents in the second category are sympathetic to governmental attempts at redistribution but think CCAs are not the best way to go about this. These opponents favor addressing the problems of wealth, income inequality, and poverty by some other means, such as basic income, stakeholder grants, or means-tested welfare programs.

In this chapter I focus on two objections to CCAs that could be advanced by opponents of the second type, specifically by defenders of stakeholder grants. My goal is not to show that the objections are ultimately convincing. I am not sure they are. I do, however, think they raise interesting issues for Widerquist's proposal. At the very least, they point to areas where the proposal could be clarified. My goal here is to articulate these issues.

I proceed as follows: First, I discuss the objection that CCAs are paternalistic in a way stakeholder grants are not. I argue that Widerquist's reply to this objection needs clarification. Next, I turn to the second objection to CCAs. According to this objection, the restrictions Widerquist puts on an account holder's access to her CCA infringes upon her right to do what she chooses with her share of the wealth that existed at the time of her birth. This second objection is related to the first in that it centers on the restrictions in the CCA system. The difference is that the second objection condemns the restrictions not on the grounds that they are paternalistic but rather for the more basic reason that they deny people access to their own property. In responding to this concern, Widerquist rejects the idea that one is a "perpetual owner" of the initial stake in one's CCA. I argue that this rejection has at least two important practical implications for Widerquist's proposal and also raises an interesting theoretical question about the theory of property rights that undergirds it.

#### THE PATERNALISM OBJECTION

As Widerquist notes, defenders of stakeholder grants "may argue that CCAs are simply stakeholder grants with paternalistic restrictions added." Ostensibly, Widerquist is willing to concede there is something to this objection, for he tells us that he "will argue that to a small extent this perception is true, but the restrictions are necessary, and to a great extent this perception is false." A natural reading of this remark suggests that Widerquist's reply to the objection will consist, in part, of his acknowledging that CCAs have paternalistic elements but then arguing that this paternalism is justified, presumably because the moral undesirability of paternalism is overridden in this instance by the morally desirable things the paternalistic restrictions help secure, in particular, the fact that people will not then be able to squander their stake, as is always possible with stakeholder grants. Alternatively, it is open to Widerquist (at least as a theoretical possibility) to argue that the elements of paternalism in his proposal are not even *prima facie* morally undesirable. However, it is not clear whether Widerquist really does think there really is anything paternalistic about CCAs, even "to a small extent."

The closest Widerquist comes to developing his concession that the perception that CCAs are paternalistic is true "to a small extent" comes in the sentence immediately following the just quoted preview. He writes: "This perception is true only to the extent that it

is impossible to enhance lifetime security without restricting people from borrowing against that future security or somehow converting those benefits into cash. If this is paternalism, CCAs have one small restriction that is paternalistic.” I will now argue that the antecedent of the conditional sentence just quoted is puzzling in a way that renders obscure what, if anything, Widerquist acknowledges to be paternalistic about CCAs. Before I do that, however, I would first like to make a quick point about the consequent of the conditional.

The “one small restriction” Widerquist presumably has in mind when he writes “If this is paternalism, then CCAs have one small restriction that is paternalistic” is the prohibition on account holders’ spending the principle in their CCAs. But this hardly seems like *one small restriction*. It is the feature of Widerquist’s proposal that most distinguishes it from stakeholder grants, and the very feature that the defenders of stakeholder grants he imagines pressing the paternalism objection have in their sights. It is also one of the very few elements of his proposal that Widerquist includes in his characterization of the “basic idea” of a CCA system. Thus, if this restriction is indeed paternalistic, then CCAs are paternalistic *to the core*, the minimizing phrase “one small restriction” notwithstanding.

Consider now the antecedent of “If this is paternalism, CCAs have one small restriction that is paternalistic.” I am not sure what Widerquist means here. In particular, to what does “this” refer? On the most literal interpretation, it refers to a fact of life, namely, that many people will compromise their future economic security if given the opportunity to do so. But when we read the antecedent this way, it becomes so obviously false that it is unlikely that is what Widerquist has in mind. There is nothing paternalistic about the fact that people tend to be willing to trade on their future security.<sup>1</sup>

This fact about human nature can, of course, *motivate* paternalistic policies, which leads to a second possible interpretation of “If this is paternalism, then . . .”: the “this” may refer to the fact that the restrictions on CCAs are motivated, at least in part, by a desire to enhance account holders’ lifetime security by protecting them from the possibility that they will trade away their future security. There are, however, at least two problems with this reading.

The first problem is that if the restrictions are motivated by a concern for the account holder’s future security, then there can be *no question* that they are paternalistic. They would be paradigmatic instances of paternalism. So, on this interpretation, the conditional nature of Widerquist’s concession—“*If* this is paternalism, then . . .”—is misplaced: of course *that’s* paternalism.

Perhaps the conditional formulation is merely rhetorical hedging. The second problem with the present reading of “If this is paternalism, then . . .” cannot be so easily dismissed. As Widerquist notes, the restriction on CCAs most vulnerable to the charge of paternalism is the prohibition on spending the principle. Yet, Widerquist explicitly denies that this prohibition is motivated by a concern for the future economic well-being of present account holders. He tells us the prohibition is there instead to ensure that enough wealth remains in the CCA fund to finance the CCAs of future account holders. As Widerquist puts it, the purpose of the prohibition “is not to protect the account holder from herself but to protect future generations from the account holder.”

Thus, neither interpretation of the antecedent of “If this is paternalism, then . . .” we have considered tells us what Widerquist has in mind when he acknowledges that CCAs are paternalistic, if only to a “small extent.” Yet, as I stated above, it is in these remarks that Widerquist comes closest to clarifying the point. He devotes the rest of his response to cashing out his claim that the perception of paternalism is “to a great extent” *false*. Furthermore, no other interpretation of the antecedent of Widerquist’s conditional suggests itself. I conclude, then, that it is unclear just what, if anything, Widerquist acknowledges to be paternalistic about CCAs.

#### THE PROPERTY RIGHTS OBJECTION

We have been considering the objection that the prohibition against spending the principle in the CCA is paternalistic, but there is a simpler argument defenders of stakeholder grants can make against the prohibition. It comes to this: if the initial stake in an account holder’s CCA is her share of the nation’s wealth at the time of her birth, as Widerquist claims, then to deny the account holder access to that stake is to deny her access to something that belongs to her, and this is so regardless of whether the prohibition is motivated by paternalistic concerns. Since stakeholder grants avoid infringing on people’s property rights in this way, the argument goes, they are preferable to CCAs.

Widerquist seems to have this property rights objection in mind when he writes:

The common definition of most forms of property awards the owner a perpetual license to do with it as she pleases with it. She can save it and pass it down to her heirs until the end of time or she can convert it

into bananas and let it rot overnight. This view of the right to property has some merit if the owner created the property entirely out of her own efforts and if the property would not have existed if it were not for her. But most of our property is made out of natural resources that belong to all of us as much as any of us and to future generations as much our generation. Your CCA is not your creation; it is your share of the stock of resources and capital that existed when you were born. You are entitled to a share of this wealth, but not as a perpetual owner, only as a custodian who has title to its returns while living but who must maintain the principal and return it to future generations at the end of life.

Widerquist suggests here that those who would demand access to the initial stake in their CCA on the grounds that it is their property misunderstand the sense in which the stake is their property. They think it is their property in a sense that would give them perpetual license to do with it as they please, when, in fact, it is their property in a different, custodial sense, one that confers much more limited rights.

For better or worse, the idea that ownership confers perpetual license is widely held. As Widerquist acknowledges, it is part of the “common definition of most forms of property.” Indeed, in my experience many people naturally regard challenges to the idea that they have perpetual license to do with something as they please *just as* challenges to the idea that that thing is their property. In contrast, the custodial relationship to which Widerquist appeals is less familiar, at least as a type of *ownership*. Many would likely regard “custodial ownership” as no ownership at all. They will wonder, for example, how something can be their property when they cannot convert it into cash and have to eventually give it back, like a library book. Of course, this is not itself a reason to reject Widerquist’s claim that that is how account holders are related to the initial stake in their CCAs. It does, however, have at least two important practical implications.

First, the move to custodial ownership limits Widerquist’s ability to effectively appeal to what many will regard as the most—perhaps even the *only*—compelling argument for using coercive taxation to redistribute wealth, the idea that the redistribution simply gives people what is in some robust sense already rightfully theirs. Suppose someone comes to support CCAs on the grounds that a portion of the resources that exists at the time of an individual’s birth rightfully belongs to that individual. If this person thinks of ownership as something that confers perpetual license (or something weaker than perpetual license but stronger than the rights of a custodian), then her grounds for accepting CCAs will also provide her with excellent

grounds for rejecting CCAs in favor of stakeholder grants, which give individuals more robust rights over their stake. Thus, attempts to justify CCAs on the grounds that the initial stake in the CCA is the account holder's rightful property will backfire with the large number of people who think of property rights as more robust than the rights conferred by custodial ownership.

Inevitably, some people will think, correctly or incorrectly, that they contribute more in taxes to the CCA system than they receive in benefits from it. A second practical implication of the idea that individuals are mere custodians of the initial stake in their CCAs concerns how these people will perceive those who rely heavily on their CCAs to make ends meet. Widerquist rightly points out that the universal nature of the program—everyone gets a CCA, not just the poor—and the fact that the well-off can profit especially well from it—besides receiving the same initial stake as everyone else, they are able to keep more money in their CCAs, which translates into the ability to convert the initial stake into a much tidier sum—are reasons to think CCAs will have popular appeal. He may be going too far, however, when he claims that it “is hard to believe that CCAs would involve any kind of stigma,” and that “no matter how accountholders spend their returns, it seems unlikely that they will be viewed as ‘recipients’ or anything but ‘owners’ who exercise one of their many options for the use of their property.” These predictions may be accurate, but the fact that account holders lack the strong property rights over the principle in their CCAs that are associated with the “common definition of most forms of property” militates against them. It makes it more likely that those who think of themselves as net contributors to the CCA system will in fact view those who rely heavily on their CCAs as recipients of a government program, not owners, and that the stigma commonly associated with relying on “government handouts” will be extended to these people.

I noted above that the ubiquity of the perpetual license conception of property does not justify it, and Widerquist raises a simple but powerful objection to thinking of one's relationship to one's CCA in those terms: “Your CCA is not your creation.” However, in addition to having the two practical implications just noted, Widerquist's defense of his claim that account holders are custodians, not perpetual owners, of the stake in their CCAs raises an interesting theoretical question about self-ownership.

Recall that Widerquist tells us that the perpetual license conception of property has merit *if* two conditions are satisfied: (a) “the owner created the property entirely out of her own efforts,” and

(b) “the property would not have existed if it were not for her.” Taken at face value, Widerquist is claiming that (a) and (b) are sufficient conditions for being entitled to perpetual license to something (or at least that those conditions being met suffices for the idea of perpetual ownership having “some merit”). It seems clear, however, that he thinks “a” and (b) are *necessary* conditions for perpetual ownership, since that is the premise he needs to reach his conclusion that we are not perpetual owners of our CCAs. But now consider the case of my body. I obviously did not create my body entirely out of my own efforts, and so condition (a) is not satisfied. Furthermore, it is at least questionable whether my body satisfies condition (b). For suppose that I am essentially something that has conscious experiences. If my body had always lacked significant portions of the brain (which seems possible), then arguably it would have existed but I would not have.<sup>2</sup> Widerquist’s conditions for perpetual ownership thus threaten the strength of the property rights one has over one’s own body. Perhaps Widerquist’s considered view of property rights does not have this implication. For example, he may view one’s relationship to one’s own body as a special case. Or perhaps he would embrace the idea that one’s rights over one’s body are not as robust as many assume. In any case, this is something that should be clarified.

## CONCLUSION

Widerquist argues convincingly that a CCA system would have important advantages over the more familiar basic income and stakeholder grants proposals. CCAs would give people more economic opportunities than they would have with a comparably sized basic income and at the same time provide more economic security than would come with comparably sized stakeholder grants. This economic security has a price, however, in the form of the prohibition on account holders spending the principle in their CCAs. I have argued here that Widerquist’s responses to two objections stemming from this prohibition raises important issues for his proposal. Specifically, I argued that it is unclear whether Widerquist is willing to acknowledge that his proposal has paternalistic elements, and, if he is, what he thinks those paternalistic elements are. I then argued that in denying that account holders are perpetual owners of the initial stake in their CCAs, Widerquist both limits his ability to effectively appeal to what many will view as the most (or even the only) compelling justification for a government redistribution program and also increases the likelihood that people who use the available returns from their CCAs

for day-to-day expenses will be seen as relying on “government handouts.” Finally, I argued that the theory of property rights underlying Widerquist’s proposal may threaten the strength of the rights one has over one’s own body. I am unsure how damaging these points are to Widerquist’s proposal in the final analysis, but I hope that by raising them I have at least helped identify ways in which the proposal might be further clarified and developed.

#### NOTES

1. See Dworkin 2010 for the standard definition of “paternalism.”
2. See McMahan 2007, 181–186.



Freedom, Development, and Oil: Citizens' Capital Accounts for Iraq

*Ayelet Banai*

*Oil revenues were a major issue in popular protests all across [Iraq] in February and March, one banner in Baghdad's Tahrir Square reading "The oil of the people is for the people, not for the thieves." The governor of oil-rich Basra was forced to resign during the protests, in which dozens of people were killed.<sup>1</sup>*

The success of a development policy may be measured on a number of different scales: for instance, its contribution to alleviation of poverty or to a more efficient use of a country's resources. One such measurement is the enhancement of the social and political freedoms of the individuals concerned.<sup>2</sup> Citizens Capital Accounts (CCAs)<sup>3</sup> include promising features in this respect; in particular, this is so for a class of developing countries with oil economies and some of the other varieties of the "resource-curse."<sup>4</sup> Oil economies in developing countries have tended to go hand in hand with authoritarianism, high levels of corruption, and clientelism.<sup>5</sup> Thus, the political and social freedoms of the citizens are not the victims of poverty as such, but of features of the social and political structures and institutions that characterize developing economies rich in oil. In recent years, international aid and development agencies, NGOs, and civil society initiatives have concentrated effort to design development policies conducive to equitable distribution of resource wealth in these countries and to institutional reform. Examples include conditionality and monitoring on investment by the World Bank; campaigns, research,

and lobbying by Revenue Watch; and legal action for clean trade in natural resources.<sup>6</sup>

CCAs are equipped to make a valuable addition to these efforts, because their potential to bypass the established channels of wealth distributions and services provision that perpetuate the problem is stronger than that of the common alternatives—that is, basic income schemes or services provision by public authority.<sup>7</sup> Under the CCA scheme, money from oil revenues is allocated directly to an independent investment fund, on behalf of and specifically for the benefit of each individual citizen—every citizen has his or her own capital account. In this chapter, I would like to explain which specific elements of the challenge CCAs can help meet and why. The CCAs were initially designed to shield citizens in functional advanced market economies from some of the threats to their individual freedom by this economic system. My suggestion that citizens face equivalent risks in dysfunctional developing market economies invites further thinking about the nature of threats to human freedom and well-being posed in general by free market capitalism as we know it .

#### OIL, WEALTH, AND FREEDOM

Iraq is a developing oil economy. The oil sector accounts for some 60 percent of the country's GDP. An astounding 95 percent of the budget of Iraq's government comes from oil revenues.<sup>8</sup> Under the current law, a share is given to the regional autonomous government of Iraqi-Kurdistan, and the rest is for Baghdad to spend. According to Transparency International's corruption index, Iraq figures as one of the most corrupt countries in the world for 2008, 2009, and 2010. In 2010 its rank improved to 175 from 178 (on a scale that runs from 1, least corrupt, to 178, most corrupt).<sup>9</sup> Iraq is still classified as not-free on the Freedom House index, with 5 points for political rights and 6 for civil liberties.<sup>10</sup>

Iraq has known extremely harsh times in recent decades of war and totalitarian rule under the Ba'ath dictatorship and a near civil war after the toppling of the dictatorship. Against the background of such harsh circumstance, corruption and restricted liberties in Iraq might seem as minute problems that need to bother no one but the dreamy idealist. This is especially so when economic data is not altogether bad: the country's economy is growing and salaries are on the rise. But for the country's natural wealth to contribute to the freedom and well-being of its citizens and for the important political and social achievements to stabilize rather than fade away, the prevailing

patterns of corruption and clientelism must be addressed. The following discussion focuses on specific aspects of these rampant problems and the ways in which the CCAs are a promising reform policy in this context. Geographically, it focuses on the northern regions of Iraq, which have political and economic autonomy under the Kurdish Regional Government (KRG). The focus on this region is due to its improved security and institutional conditions in comparison to other parts of the country, which means that it is a promising place to initiate reform.<sup>11</sup> Before turning to highlighting the problems of clientelism and corruption, it should be emphasized that the provision of basic security has been achieved by the local authorities in the KRG areas, material well-being of the region's residents has, on average, improved, free parliamentary elections have taken place, and legal reform has begun.

In the following pages, I focus on the potential of the CCAs as a reform policy in Iraq, with an important caveat. The transition years of 2003–2004 were an opportune political moment to put in place programs or institutions to manage Iraq's oil revenues for the benefit of its citizens. This moment has passed, and now when new structures of clientelism have taken root, it is likely to be very difficult to mobilize effective political support for any policy of public resource management that would undermine the control over oil revenues of those currently in power. The brief comments here, then, focus on why CCAs are a policy worth advocating.

#### THE SITUATION IN KURDISTAN

Consider the area of Halabja in Kurdish northern Iraq, near the Iranian border. Its villagers and town dwellers have known decades of extreme hardships due to war, civil war, and harsh political oppression. In the period since the beginning of the Iran-Iraq war in 1980, the inhabitants of the area were expelled from their towns and villages, fled war, were massacred, and had their lands expropriated and their villages razed. The "Anfal Campaign" carried out by Iraqi military in this region and the poison gas attacks on the inhabitants of Halabja in 1988 have given the extreme hardship of the region some international attention.<sup>12</sup> Today, after the toppling of the Ba'ath dictatorship and the official recognition of the autonomy of the Kurdish region in the new Iraqi constitution and political system,<sup>13</sup> the conditions of the population in this and other provinces in northern Iraq have dramatically improved in respect to their basic security and their legal recognition as citizens of their own country.<sup>14</sup> Economic

opportunity has also improved, insofar as the double embargo that was imposed on the region during the 1990s has been lifted, the borders to Turkey, Iran, and the rest of Iraq are open to commerce, and national oil revenues are allocated to the KRG.

Where, then, are the challenges ahead? In devastated societies that have known war, civil war, displacement, and expropriation, it is well known that it is difficult to reestablish the kind of interpersonal trust and “social capital” conducive to free social, economic, and political institutions and to the development of public goods and services. The clientelist structures and high levels of corruption associated with the oil economy add a dimension to this problem for which CCAs have the potential to contribute to an effective response. How so? The makeup of oil-based clientelism is rather straightforward. Oil revenues (by far the most important source of wealth in the Iraqi economy) flow from the central government in Baghdad to the regional government, which then distributes them to loyal local governors and supporters in return for their political support. Following a recent reform, the local governors are now elected (and no longer appointed), which opens an important path to public accountability. However, the municipal authorities have no budget independence, and so in order to be able to spend in their constituency, they are still in need of patrons at the political center. Access to services such as identity and travel documents, business registration, education, health, and culture have thus become entangled in personal favors, rather than being publicly open. BBC journalist Kate Clark reported that “ordinary Kurds are struggling to survive, while state money gets siphoned off into private pockets.”<sup>15</sup> Even in the region’s larger and central cities, supply of electricity and clean water is not yet secure. In more peripheral areas, such as the villages around Halabja, standard services, such as medical and social services, trivial facilities such as a playground or a public library, or even clean drinking water, are lacking.<sup>16</sup>

It should be emphasized that the problem at stake here is not “merely” a failure of *public* authorities. After all, some market fundamentalists might find it desirable to keep the provision of public service, from infrastructure to education, in private hands. But even if provision of services by markets were, in general, a good or practicable idea, the patterns of clientelism and corruption hamper the markets as well; not only are business registration and commerce subject to the same patronizing agents but also no system of private insurance has yet emerged: for instance, health, cars, and homes are not insured—privately or publicly.<sup>17</sup> Further, substantive funds do flow from the political center to municipal authorities, groups, associations, and

individuals. The challenge is in creating accountable procedures and support for the idea that what is being spent by public authorities are funds that also belong to the citizens. Where taxes are low and their collection rates are low too, it becomes less self-evident that the body of citizens has certain entitlements to the funds. As explained in a recent economy briefing from Iraq: the challenge is to create procedures for the allocation of the oil benefits that will transform it from a charity by benevolent rulers to acceptable standards of social justice—“no more charity.”<sup>18</sup>

Note that clientelism is not necessarily dysfunctional in providing public services and infrastructure. Rather, it is its combination with oil wealth that seems to increase the tendency to maintain dependence of citizens on patrons. The production of oil and trade in it are centralized, which means that wealth flows from the center to the peripheries—a “top-down” pattern. Encouraging decentralized production of wealth and provision of services in a “bottom-up” mode would mean direct competition for those currently privileged by the system, and a risk to an important source of their privileges. To encourage change, this structure needs to be challenged by the dependents themselves, who are obviously in an unfavorable position to create this challenge. International development agencies and NGOs that have allocated budgets and efforts to political, social, and economic development projects in the region have indeed found their resources unwittingly reinforcing the existing clientelist patterns. State agencies for aid and development and donors tend to work—sometimes for good reasons—with official governmental structures and administration, which control the way aid money is being distributed.<sup>19</sup> But even many attempts to channel funds to local NGOs often—though not always—fail to challenge the social clientelists structures, either because the organizations are being co-opted or due to the reluctance of many international donors to get into conflict with local authorities.<sup>20</sup>

#### ISLANDS OF REFORM

Against the background of these patterns of corruption and clientelism, some islands of alternatives and calls for reform have emerged in recent years through the work of journalists and some local and international associations. In 2006, a local initiative of the residents of Halabja organized a boycott of the official memorial ceremonies,<sup>21</sup> demanding that the regional authorities should go beyond ceremonial declarations and fulfill in reality their promises of development

in Halabja and its area. The initiative, which included a mass demonstration (which turned violent), continued to pressure the regional authorities and succeeded in claiming funds and resources for their town and attracting unprecedented media attention.<sup>22</sup> In 2008 a local coalition of human rights and women's rights associations organized a protest against a personal status bill before the regional parliament that permitted polygamy. This too was a case of successful mobilization from below to challenge the regional authorities and their patronage.<sup>23</sup> In the regional elections of 2009, a newly formed party—Goran (“Change”)—won 25 of 111 seats in the regional parliament, campaigning on an anticorruption and free media ticket.<sup>24</sup>

These are only some examples of pioneering grassroots efforts to challenge and transform political power and its structure of clientelist control. In this context, where agents of reform have struggled to create some space for their action, creative policy proposals will make a contribution to the reformist struggle. The CCAs, or an adjusted version thereof, make an interesting policy proposal in this context because they promote the idea that the oil wealth will, in part, even if in a rather modest part, be distributed *not* through official government and administration channels but directly to citizens. This aspect of the proposal will contribute to change, both in people's perception—bringing forth the idea that the money does not come as a favor from the government but is an entitlement of the citizens—and in practice, by beginning to create some independent sources of income and wealth. This is not independent from oil, of course, but autonomous from the structures that currently control the distribution of the oil wealth.

CCAs are suitable to this task because of three features. (1) The collective fund is relatively easy to monitor. The initial sum and the investment fund can be managed by a trusted body and is easier to control than budget lines in public spending. Thus, it can be subject to citizens' monitoring. (2) The wealth in the fund does not depend on the country's general economic performance. Unlike basic income—to the extent that it is funded from a general tax revenue—the sum of money received by citizens does not depend on the country's general economic performance, but is rather directly related to the success (or failure) of the investment of the fund by its managing body. Thus, where economic performance is low—in part due to corruption—this has no bearing on the sums gained (or lost) by citizens through their capital accounts. (3) The accounts are individually assigned, and the conditions of withdrawal of the money from them are relatively strict—only for one's own purposes, and a sum needs to

remain for future investment. Such conditions contribute to shielding this income and its holders from potential co-optation (though not from extortion).<sup>25</sup> In order to make citizens' control feasible, it would be preferable to carry out the administration of the fund at the provincial level. Iraq is divided into 18 provinces (governorates), and citizens' access to authorities is easier at the provincial than at the national level. Equipped with these three features and with possible adjustment for the Iraqi socioeconomic environment, the CCAs initiative will help setting in motion a slow and long-term development of more accountable social and political institutions, by helping to bypass the clientelist patterns of current allocation, and thus take action toward meeting one of the most pressing challenges to the future development of Iraq.

#### NOTES

1. West 2011, 21
2. Sen 1999; van de Pas et al. 2011.
3. Widerquist, chapter 13, in this volume.
4. On the resource curse and its effects on development, see, for example, Ross 1999; Ross 2001; Rosser 2006; Karl 2005; Cremer 2006, chs. 4 & 5.
5. Clientelism is not necessarily dysfunctional in this regard: it could in some circumstances deliver public goods and services. See, for example, Piattoni 2001, 19ff, 193–200.
6. See, respectively, Mattner 2011; Information on campaigns from the past decade from Revenue Watch Institute (at <http://www.revenue-watch.org>); Wenar 2008.
7. On the “bypass strategy” as a response to the “resource curse,” see Rosser 2006, 25. See also Robinson et al. 2006.
8. BBC News (no date specified); Al-Salhy 2011.
9. Rogers 2010.
10. Freedom House 2011. Freedom House's surveys provide two rankings: one for civil liberties and one for political rights. Both rankings are on a scale from 1 to 7, with 1 being most free and 7 being most repressive.
11. On development and democratization initiatives in Iraqi-Kurdistan and their potential for other regions of Iraq, see Uwer and von der Osten-Sacken 2006.
12. Hiltermann 2007.
13. Article 4 of the Iraqi Constitution recognizes Kurdish as an official language of Iraq. Article 117 recognizes the region of Kurdistan and its existing authorities as a federal region. Two main Kurdish parties, KPD and PUK, won 53 seats, for a common list, in the national

parliamentary elections of 2010. Head of the PUK, Jalal Talabani, is the president of Iraq.

14. Between 1991 and 2003 the region was under de facto autonomous control of the two Kurdish political parties (KDP and PUK) and their security forces, which provided basic public services in a place that had no state authorities in operation.
15. Clark 2008.
16. Qadir 2007; Clark 2008.
17. Mawloody 2010; The World Bank Group 2011.
18. Al-Obeidi 2011.
19. See USAID (2011) for example of list of contracts and awards for Iraq in general.
20. Van de Pas et al. 2011.
21. March 16, the date of the chemical attack on the town of Halabja in 1988, is a memorial day.
22. Khalil 2006; Westcott 2006; Worth 2006.
23. Muradkin 2008.
24. Information on election results and political parties is available at Carnegie Endowment for Peace 2010.
25. By extortion, I mean the possible emergence of “protection” networks. Where public security services are weak, there is space for private entrepreneurs to offer security in exchange for payment.



Citizens' Capital Accounts:  
A Comment

*Christopher L. Griffin, Jr.*

Karl Widerquist's proposal for Citizens' Capital Accounts (CCAs) is at once intellectually innovative and eminently practical, perhaps even more so than previous suggestions for creating universal asset-based welfare policies. At present, the most concrete divide regarding the scope and use of such a policy pits basic income proponents against their stakeholder grant counterparts. Both camps rightly demand neutrality over the terms by which citizens spend their collectively financed grants. Widerquist's plan, however, extends the neutrality principle to *when* individuals may draw on the available portion of their accounts, thereby combining—if not blurring—the most critical distinguishing feature of prior proposals. Basic income plans allow for a steady stream of payments over time; Bruce Ackerman and Anne Alstott's stakeholder society<sup>1</sup> reserves benefit payments for the moment at which mature adults assume the mantle of full citizenship. Widerquist's description of CCAs in chapter 13 not only sets out with requisite detail a feasible operational design for CCAs but also a critical evaluation acknowledging its strengths and limitations.

In this chapter, I offer some suggestions for rethinking portions of Widerquist's proposal in the hope of buttressing his already valuable contribution. In doing so, I pose a few questions, none of which can be analyzed fully in this space, about alternatives to some core elements of his idea. In my opinion, the most important feature precluded under the CCA proposal—family contributions before the account holder reaches maturity and account holder contributions

thereafter—might undermine powerful saving incentives that CCAs should promote. Furthermore, the proposal might appear more attractive to policy makers if such contributions could relieve the initial wealth tax bill necessary to ensure CCA solvency as well as pressures on those who need to draw down available returns earlier in their life cycles.

In what follows, I examine three aspects of Widerquist’s proposal: (1) its adherence to important principles in previous asset-based welfare work while offering new, clear advantages; (2) whether to allow subsequent pay-in and prohibit parental withdrawal; and (3) the relationship between these issues and the likelihood that CCAs will represent the best of both worlds for basic income and stakeholder grant supporters.

## I. CCAS AND EXISTING UNIVERSAL ASSET POLICIES

Among the more desirable aspects of Widerquist’s CCA plan is that citizens could apply their expanding balances either to more ambitious objectives conceived for the stakeholder society (e.g., funding higher education) or to more immediate needs traditionally covered by a basic income. As a result, no proposal as of this writing combines the hallmarks of both schemes so seamlessly and without threatening the proposal’s long-run viability. In other words, rather than wedging his universal asset program into the narrow boundaries of basic income or stakeholder grants, Widerquist has devised a true hybrid through principled rules regarding constructive ownership over the principal combined with withdrawal limits. Without one or the other feature, CCAs probably would converge toward a basic income or stakeholder system. Such convergence is not inherently unattractive. Rather, CCAs seem to quash the long-running assumption that universal asset policies *must* embody one commitment over the other. CCAs ultimately demonstrate that choosing among potential funding and distribution schemes need not be a zero-sum game.

In addition, although Widerquist’s wealth tax choice represents one of several acknowledged possibilities, it is worth mentioning an argument I have made elsewhere that the distinctive feature of Alaska’s Permanent Fund Dividend (PFD) is its connection to natural resource revenues.<sup>2</sup> Because the PFD is financed by Alaska’s oil income, the legislature can sidestep completely the often intense debate over the fairness of resorting to personal or corporate taxes when funding a new commonly shared resource. The “endogeneity” of natural resources

insulates the merits of a universal asset program from the contentious decision over which externally created income base should be taxed. Nevertheless, Widerquist's choice of a wealth tax, motivated by its simplicity in model calculations, strikes me as a fitting alternative. At the very least, the initial stakes should be financed by the store of capital generated within the country's borders. Implementing a CCA scheme demonstrates explicitly a commitment to preserving economic security for current and future generations, to which basic income and stakeholding enthusiasts both adhere. Authenticating that commitment will require some shared sacrifice, and the most equitable option appears to be a modest wealth tax.

On the other hand, both the basic income and stakeholder grant paradigms presume uniformity in benefit levels within their respective plans, and the closest real-world example, the PFD, manifests such uniformity. Alaska residents receive an individual sum each year determined by the equal division of the total available revenues among eligible persons.<sup>3</sup> Widerquist's numerical illustration of CCAs appears to encompass uniformity in available funds *conditional on withdrawal behavior up to that point*. Thus, regarding the issue of equality, he acknowledges the likely criticism that "if wealthier people make fewer withdrawals, CCAs distribute more money to those already well off." But he reasons that "the larger returns available to someone who does not use them earlier in life come entirely from interest, not from tax revenues. The tax revenues that support CCAs are distributed equally to everyone, and the added benefit of interest is necessary to achieve the universalizing effects discussed above."<sup>4</sup>

I find this response quite persuasive and a sufficient reason for CCAs to depart from the guaranteed uniform benefit framework of proposals past, including the PFD. Indeed, the hybridization of basic income and stakeholding made possible by CCAs would disappear if Widerquist remained wedded to rigidly uniform payments. Since personal choice (or more fundamentally, one's discount rate over future events) determines the real value of CCAs over time and all citizens have the opportunity to receive equal payments, the proposal adequately sustains a new form of the equity principle, the *sine qua non* of universal asset policies.

Finally, CCAs represent a marked improvement with respect to how citizens repay their stakes, which does not typically enter basic income discourse but still was at the heart of the first stakeholding proposal. Under the original Ackerman and Alstott framework, the account holder would possess the entire balance in trust and would have an obligation to repay the stake plus interest from his estate

upon death. Clearly, as the proportion of account holders that squander their stakes increases, the system's long-run stability decreases. Administrators would be forced to return to some form of income taxation once the program lost its ability to self-perpetuate. With a mandate that the entire \$50,000 principal and one-third of accrued interest remain in each CCA, the program's long-run solvency should be more effectively promoted, if not assured.

## II. FAMILY CONTRIBUTIONS TO AND WITHDRAWALS FROM CCAS

My central criticism of CCAs, which I do not consider fatal but still do not relegate to the periphery of the discussion, involves Widerquist's explicit rules about family participation during childhood. Specifically, he states that "[n]o additions to principal are made by the government during a person's life" and allows parents to withdraw a child's available return "for the child's benefit."<sup>5</sup> The first imperative does not automatically preclude family additions, but silence on this matter effectively suggests that no contributions would be allowed under a CCA scheme. Many reasons exist to reject any contributions regardless of their source, but allowing annual or even daily withdrawals seems unfairly incongruous.

Take, for example, the so-called argument against "stakeblowing."<sup>6</sup> Widerquist's choice not to adopt a hallmark of Ackerman and Alstott's stakeholder grant by allowing for capped withdrawals at any point in the account holder's lifetime cuts in at least two directions. For stakeholding detractors, "stakeblowing" still remains a potential issue. As Widerquist's parameterized calculations demonstrate (Table X.1, Column 3, chapter 13), an individual withdrawing her entire available balance at age 21 (the same age at which most stakeholders under Ackerman and Alstott's plan receive their lump sum grants) would have just over \$30,000 on hand. Waiting until age 30, however, would nearly double the receipt. Although we might presume that the 30-year-old would be less likely to squander her share of national wealth on frivolous gambles or short-term luxury consumption, stakeblowing critics still can use Widerquist's conservative calculations to complain that sizeable CCA funds might disappear overnight. Yet, as under traditional stakeholding principles, Widerquist rightly remains agnostic about how account holders spend their benefits. Any alternative rule would introduce unnecessary paternalism into the system; the government ultimately would play the role of cultural, social, and economic arbiter. On the other hand, the conventional stakeblowing

rejoinder loses steam because both the account principal and one-third of overall returns are off limits. CCAs never can be liquidated in full; there will always be a rainy-day fund, albeit a rather small one. As a result, individual account holders are barred from squandering their entire stakes, and the rest of the system's beneficiaries will never be in jeopardy of losing their fair share.

Even if stakeblowing arguments carry less force under a CCA regime, restricting all contributions while allowing continuous withdrawals seems unbalanced. More important, introducing symmetry in account activity might further ensure the system's viability while creating a culture of responsible life cycle saving. Despite current funding setbacks—related solely to the kind of government contributions that Widerquist prohibits—the UK's Child Trust Fund (CTF) provides helpful guidance. The CTF has spawned numerous empirical studies, and available statistics indicate that if US savings patterns with respect to child welfare were similar, CCA architects could expect nontrivial additions to individual accounts.

Evidence drawn shortly after CTFs were introduced suggests that parental contributions to CCAs likely would be real contributions to life cycle returns and not simply reinforce preexisting socioeconomic inequalities. Surveys conducted between 2005 and 2006 (three to four years after the first UK cohorts had CTFs established) were designed to capture attitudes about a variety of account features, from the preferred type of CTF account to the relationship between household characteristics and account management. On the topic of prospective parental savings, the survey revealed a significant distribution over possible values, not just a clustering around zero or the maximum allowable amount. Specifically, “seven per cent of all parents with eligible children expected less than £100 to be added; at the other extreme, 13 per cent expected £500 or more to be paid in. Just three per cent said they expected the maximum of £1,200 to be added.”<sup>7</sup> Even more important, regression analysis showed that only parents' attitudes about saving for their children in general was a significant predictor of prospective additions to CTF accounts: “Parents with positive views about saving for children were 1.3 times as likely to expect money to be added to their child's CTF account in the next 12 months.”<sup>8</sup> Finally, regression estimates confirmed that levels of, and changes in, income had no statistically significant effect on savings plans.<sup>9</sup>

The converse of parental contribution—early parental withdrawal—makes pragmatic sense for CCA policy. Reasons might still exist for eliminating parental interference altogether, if not changing

the restrictions so that parents can only contribute but not withdraw from CCAs. Widerquist clearly contemplates that early withdrawals will be put toward altruistic use: “The parent who has custody of a child can withdraw the child’s available returns for the child’s benefit . . . [T]he parent has the discretion to decide what is in the child’s best interest.”<sup>10</sup> There are at least two reasons aside from distrust over actual (as opposed to ostensible) parental motives to block early withdrawal. First, if a parent finds himself in a dire financial situation, resorting to available CCA returns effectively serves as a disincentive toward responsible saving and consumption. Although affected children might benefit from stopgap measures like early CCA withdrawals, parents might have facially legitimate reasons but nevertheless inefficient incentives for raiding a child’s CCA. Second, governmental oversight, if permitted at all, arguably should pertain to early withdrawals. Widerquist’s faith in parents to decide what is in the child’s best interest furthers the neutrality interest, but at what cost? If CCAs are to combine the paramount features of basic income and stakeholder grants, then delegating expenditure authority to spendthrift parents might deprive future generations of the very economic benefits promised by CCAs.

### III. CCAS AND THE FUTURE OF BASIC INCOME AND STAKEHOLDING

As I observed at the outset, Widerquist has thoughtfully designed CCAs to exploit the best of both worlds for basic income and stakeholder grant supporters. Limits on withdrawals combined with the separation of principal and interest returns give account holders maximum flexibility, subject to the preservation of principal for themselves and for future generations, in determining the best use of their shares. As a commentator more associated with the latter camp, I remain somewhat unsure about whether CCAs will be just as likely as a convenient stream of basic income to provide a stakeholder-society-size grant at adulthood. Ackerman and Alstott’s initial objectives offer a version of economic security that those who discount the effects of discounting often fail to appreciate. In other words, there is something to be said, despite stakeblowing critics’ fears, for distributing sums large enough to finance major life plans rather than allowing individuals to expend their shares as quickly as possible.

One of the easier ways to guarantee that CCAs function doubly as short- and long-term capital stocks is to allow offsetting contributions, especially during the account holder’s infancy. Instead of

tinkering with the initial stake, increasing the minimum investment, or decreasing the allowable withdrawal limit, permitting tax-free additions to accounts should only make the choice between basic income supplements and larger-scale stakeholder grants all the more real for mature citizens. As Widerquist's current proposal would operate, I have little doubt that *in the later years of one's adult life* CCAs can provide equally a modest income or a substantial influx of assets. Why not, as stakeholding proponents advocate, make this option available earlier in life, say around the time that major decisions about education, homeownership, and family life are most salient? Opening CCAs to additional contributions, subject to a well-calibrated limit (to prevent more affluent households from using accounts as tax shelters), could nudge the proposal even closer to the once inconceivable heights of the stakeholder society plan.

To understand why this distinction could be significant, consider the obvious alternative: opening a commercial savings or investment account to provide for the future. Individuals with disposable income that otherwise would be placed in their CCAs (without the current restriction on contributions) might earn comparable *percentage* returns through accounts created by financial institutions. The *absolute* returns, however, will be much larger if the same funds are applied toward the CCA's available returns component, because the underlying principal should (in most cases) be larger than the individual's principal in a private account. In other words, citizens can capitalize on the store of value already available in their CCAs. Individuals will be able to realize greater investment returns earlier, which in turn would help fund major life plans or a modest annual income in their later years.

#### IV. CONCLUSION

Karl Widerquist's truly novel proposal deserves much more sustained consideration than I can offer in this space, and I hope that his contribution to this volume will generate more responses and discussions. In the meantime, I have used this opportunity to point out some of the CCA proposal's more noteworthy aspects while questioning whether we might be able to "do better." I suspect that along with the decision to open CCAs to parental (and later, account holder) contributions, the choice of an initial financing mechanism will transform from a model construct to a real policy dilemma. Widerquist's current thinking adopts a second-best approach to natural resource taxation, which ultimately makes sense when creating a universal asset program

for an entire nation. Any form of taxation aside from a flat tax will burden particular jurisdictions, individuals, or industries more than another. Levying revenues from shared natural resources certainly would exact differential, uneven costs on some portions of society (likely correlating with geographic characteristics and urban or rural status). Until the political process takes up the merits of CCAs, taxing wealth should adequately meet the universal asset welfare criterion that first-generation stakes come from the wealth held and created by all.

#### NOTES

1. See Ackerman and Alstott 1999.
2. See Griffin 2012, 163–165.
3. Alaska Stat. § 43.23.025 (2010).
4. Widerquist 2012, \*\*.
5. Widerquist 2012, \*\*, \*\*.
6. See Ackerman and Alstott 1999, 194–196.
7. Kempson et al. 2006, 109.
8. Kempson et al. 2006, 110.
9. Kempson et al. 2006, 110.
10. Widerquist 2012, \*\*, \*\*.



Reply to Comments

*Karl Widerquist*

I would like to thank all of the participants for their useful comments on my proposals for Citizens' Capital Accounts (CCA) and reply briefly to each of them.

I appreciate Michael W. Howard's desire to phase-in CCAs as quickly as possible. As Howard and I argued previously, a quick start-up is important to making any proposal of this sort relevant and politically strong.<sup>1</sup> But I strongly disagree with his suggestion of a very high, onetime jubilee wealth tax of 29 percent. That's simply too high for a wealth tax. While an income tax at that level is bearable, wealth is very different from income, and has to be treated very differently from income. Invested wealth typically returns 4 percent to 7 percent per year. On a bad year it could be less. An investor having an especially good year can do much better, but only a few investors manage this. An extremely high income tax of 90 percent will take only 0.9 percent of the returns if an investor makes 1 percent per year, 6.3 percent if the investor makes 7 percent, and 18 percent if the investor makes 20 percent. Even though the tax is enormous, all of these investors remain in the black. But a 29 percent wealth tax would put all of these investors into the red. The investor making 1 percent would have to turn over all profits and sell 28 percent of the business. Even the investor making a very high return of 20 percent would have to turn over all profits and sell 9 percent of the business. A tax that caused almost every business in the country to lose money—even for only one year—would cause capital flight and massive equity and efficiency problems. A very important principle that any progressive policy maker needs to follow is that tax and

regulation policy needs to be simple and predictable. Huge sudden shifts in the rules can be more burdensome than the level of tax or the strength of the regulations.

Although I disagree with Howard's solution, the problem he addresses is a difficult one that requires more thought. How can we phase-in CCAs more quickly without causing enormous problems for business? For one answer, I refer to another lesson from the concluding chapter from our earlier book: look for opportunities.<sup>2</sup> Alaska could have phased-in something very big like CCAs in the early days of the oil boom, but it chose instead to eliminate the income tax. I haven't looked at the numbers, but the United States might have had the opportunity when it introduced digital television broadcasting, but it chose instead to give away this valuable resource for free. The 2008–2009 financial meltdown might have been a great opportunity for the US government to buy banks at fire-sale prices instead of subsidizing those banks, but, again, I haven't looked at the numbers. Opportunities do come along, but can we jumpstart something as big as CCAs without some unusual opportunity. I think there are ways, but any particular proposal should be looked at with strong skepticism and studied carefully, because the damage to the economy could be severe.

Jason Berntsen (chapter 15) has two closely related comments on my argument for CCAs. He asks for clarification of my contention that the restrictions on CCAs are arguably paternalistic only in a small way, and argues that someone might support the idea that a portion of the resources existing at the time of an individual's birth rightfully belongs to that individual, but he rejects the idea that such ownership is custodial.

A response to both comments requires a clarification of the difference between a stock and a flow variable. A flow variable is a rate; it can only be measured per unit of time. A stock variable is not a rate but a flat amount unrelated to the length of the time unit in which it is considered. The number of apple trees in an orchard is a stock variable. The rate at which those trees bear fruit is a flow variable. The purchase price of a home is a stock variable. The rental price of a home is a flow variable. Personal or national wealth is a stock. Personal or national income is a flow. Wealth is the amount of money a person or an institution has at any given time. If my wealth did not change at all last year and it was \$200,000 on any given day last year, it was also \$200,000 on any given week, month, or for the whole year. Income is the rate at which a person or an institution has money coming in. If my income did not change at all last year, and it was \$100 dollars per

day, it was also \$700 per week, \$3,000 per month, and \$36,500 per year. Even though my income did not change last year, the numbers in which it is reported differ by orders of magnitude depending on what unit of time we use to calculate the rate.

The principal of a CCA is a stock variable, the rate of return on a CCA is a flow variable. With this in mind, consider the large restriction on CCAs: account holders cannot withdraw the principal (the stock variable). The small restriction is that the government will not enforce a loan collateralizing future returns (the flow variable). I will argue that the large restriction is not in any way paternalistic. The small restriction could be interpreted as paternalistic, but even then, I do not think it is correct to call it paternalistic.

Paternalism is in the motivation. Suppose I won't let you play with my gun because I think you'll shoot yourself, and I don't want you to hurt yourself. In this case, I am being paternalistic; I am protecting you from you. But suppose I won't let you play with my gun because I think you'll shoot yourself, and I don't want you to waste the bullets I intend to bequeath to my offspring. In this case, I am *not* being paternalistic toward you; I am protecting future generations from you.

The restriction against individuals accessing the principal of their CCAs is similarly motivated. The principal of your CCA represents your share of the capital and resource stock that exists at the time of your birth. It would be a very bad thing for all of us and for future generations if large numbers of people tried to convert the capital and resource stock that existed at the time of their birth into present consumption—as they could if they had a full property right over this stock variable. This restriction protects their interests. It also protects their rights. People who are arbitrarily born in year  $X$  have no more claim to the capital and resource stock of the earth than people born in year  $X+1$ . If people born in year  $X$  choose to destroy that stock by turning it into present consumption, there will be no capital or resource stock left for future generations to get a share of. They will violate the rights of future generations to a share of that stock. Therefore, I conclude that the big restriction is in no way paternalistic.

The small restriction on CCAs is that the government will not enforce any contract in which individuals borrow against their future returns. Berntsen points out that I write, “If this is paternalism, CCAs have one small restriction that is paternalistic.” It should now be clear that this is a small restriction because it applies only to the flow of returns to CCAs, but it does not apply to the large restriction on the stock of principal in CCAs.

I should have written, “If this is paternalistic *and* it can be thought of as a restriction on CCAs, then CCAs have one small restriction that is paternalistic.” One can construe this policy as a paternalistic feature of CCAs, but I don’t believe this policy is best thought of either as a restriction on CCAs or as paternalistically motivated. No CCA rule prevents an individual from promising to pay back a loan from future CCA returns. What is not allowed is for the individual to claim that if they change their mind about paying back the loan, the government will force them to turn over their future CCA returns. This rule is not really a restriction on CCAs, nor is it a restriction on individual behavior at all. It is simply the refusal to aid certain kinds of behavior by positive government action (the enforcement of loans). No bank will write a loan under those conditions, but they have no right to demand that the government take action to create the conditions in which they would make such a loan. There are many loan contracts the government refuses to take positive action to enforce. It will not enforce a contract in which individuals promise to become slaves, to turn over their voting rights, or to sacrifice their free speech rights, if they can’t pay back the loan. These rules should not be considered paternalistic restrictions on self-ownership, voting rights, or free speech; they are simply the refusal of the government to aid creditors by forcing debtors to turn over certain forms of collateral.

Furthermore, I do not think that denials of aid, such as these, are paternalistically motivated denials of aid. The government refuses to enforce such contracts because it has no duty to enforce all contracts people might wish to make, but it does have a duty to protect their freedom of speech, the freedom to vote, and the freedom from involuntary servitude. The government’s refusal to aid people in signing contracts alienating these rights should not be motivated by a paternalistic concern for their welfare but for a concern for what the government owes individuals.

I have argued elsewhere that I believe society owes people basic security as much as it owes them protection against enslavement. I won’t reiterate the reasons here.<sup>3</sup> The duty to protect basic rights and basic security takes precedence over society’s responsibility to aid individuals by enforcing loans. Therefore, the government can only give individuals such aid if doing so does not interfere with the basic rights protections that society owes them. The government cannot claim that it no longer has to protect your basic rights simply because it helped you get a big pile of money earlier in life. Any such policy sacrifices the protection government owes individuals for an optional service that the government does not owe them.

Berntsen goes on to make a property rights argument against CCAs and in favor of stakeholder grants. He writes that someone might favor the argument “that a portion of the resources that exists at the time of an individual’s birth rightfully belongs to that individual” in the sense of full unrestricted property rights, not in the custodial sense that I considered. Berntsen goes on, “If this person thinks of ownership as something that confers perpetual license . . . her grounds for accepting CCAs will also provide her with excellent grounds for rejecting CCAs in favor of Stakeholder Grants.” He even portrays this restriction as being opposed to our general understanding of property, writing “They will wonder, for example, how something can be their property when they cannot convert it into cash and have to eventually give it back, like a library book.”

I will respond to the second point first. Now that I have clarified the difference between stock and flow variables, it is more obvious that the property rights conferred on individuals by CCAs are consistent with our normal understanding of property rights. By a custodial sense of ownership, I mean full ownership over the flow of returns to the stock of resources that exist while they are alive, but they have less than full ownership of the stock of resources. This rule is consistent with normal understanding. A person who rents an apple orchard understands that she has full ownership over the fruit the trees bear during the term of her lease, but that she has a responsibility to return the trees in good condition at the end of the lease. A person who rents an apartment understands that even though she must return the apartment to the landlord or to the next tenant at the end of the lease, and even though she must be a good custodian of that apartment during her lease, she understands that during her lease she still enjoys very meaningful rights over that apartment against anyone else, including her landlord and future tenants.

In response to the point that a person could believe that individuals should have full, noncustodial, permanent ownership of the stock and flow of resources that exist at the time of their birth, I argue that this view is inconsistent with *all* people having this right. If people born in the year  $X$  have this right, they will take full ownership over the stock resources that exist at that time, and there will be no resources left for the people born in year  $X+1$  or any other year after that. The belief in an equal right to resources is simply incompatible with the permanent ownership over the stock of resources. It can only be consistent with ownership of the flow of returns.

Ayelet Banai (chapter 16) argues that Iraq in general and Kurdistan in particular are good candidates for the introduction of CCAs,

because CCAs are individualized, easy to monitor, and less vulnerable to clientelism than many policies often adopted by resource-rich developing nations. I agree, but I believe Iraq embodies the difficult aspects of some of the trade-offs I discuss in chapter 12 of this volume. Infrastructure investment is very vulnerable to clientelism, but, nevertheless, the need for it in Iraq is unavoidable. Furthermore, although Iraq has a lot of oil, it also has a lot of people. It has more than 25 times Alaska's population. Thus, its oil wealth will get spread much thinner. It will need other taxes, whether the kind Flomenhoft mentions in his chapter (chapter 6) or more traditional income and sales taxes to create meaningful CCAs.

Christopher L. Griffin, Jr. (chapter 17) gives me the opportunity to clarify, defend, and perhaps soften my position on parental withdrawals and additions to CCAs.

My original draft of what became this CCA chapter actually included no parental withdrawals. Giving credit where due, it was Almaz Zelleke who talked me into allowing them.<sup>4</sup> The reasons are strong and I believe good, as I outline them in the original paper. Few things are more damaging to an adult's life prospects than childhood poverty. No amount of money later in life can make up for it. Any policy that risks greater childhood poverty to ensure greater financial support for the same people in adulthood is, therefore, foolish.

The common response is that at least some parents will use the child's CCA for their own benefit, and therefore, supposedly, we should supervise every account holder's parent. But supervision does not follow. We know that some doctors, lawyers, stockbrokers, and business owners neglect their children and spend too much of their income on themselves, even though they have a legal responsibility as parents to spend sufficiently on their children. Yet, one never hears proposals to garnish the salaries, capital gains, profits, and bonuses of all upper-class parents to put that money into a special account that will be specially designated for the children and closely supervised by social workers. Why not? Hopefully, because we know neglectful parents make up such a small portion of parents that such cumbersome oversight would be a waste of time, at best, and likely to cause more trouble than it is worth, at worst. Instead, we have laws to prosecute the small percentage of neglectful parents.

Yet, when it comes to policies to ensure that poor parents are less poor, suddenly proposals for prior supervision of all parents become ubiquitous. This inconsistency, I believe, stems from an undue suspicion of the poor. I believe most of the poor are people like everyone else who happen to be in more difficult circumstances. Most of the

poor do not abuse or neglect their children. It would be the same foolishness to subject all of them to humiliating oversight, as it would be to oversee the spending of all upper-class parents. If parents show probable cause of neglect, their CCA withdrawals should be one of the things investigated, but simply prohibiting parents who may need to withdraw from their children's CCAs to provide them with basic necessities would be counterproductive.

I will soften my position on this issue in two ways. First, perhaps too many parental withdrawals relative to the parents' income might be interpreted as a sign of neglect and could be one factor in establishing probable cause for investigation. I fear that such a policy could be abused by investigators, but it might be worth it if it helps neglected children. Second, children should be able to sue their parents, or request an investigation, if they believe the parent has misused their CCAs, once they are old enough to understand and are into adulthood. Parents' CCA returns should *not* be a protected asset against a ruling that the parents have misused their children's CCAs. Of course, by the time the child gets any restitution, their most vulnerable years will be over, but knowledge of the possibility will hopefully create an incentive against indefensible parental withdrawals.

As for parental additions, I am all for them, and I am for individual additions during adulthood as well. There are two intertwined questions about additions. First, do we need some kind of restrictions on them to prevent abuses such as dodging taxes or creditors? Second, which of the features of CCAs should apply to additions? I cannot give a definitive answer to these questions in this space, but I can begin the discussion.

Normally, CCA principal can never be withdrawn by the account holder, and it is completely protected from creditors and lawsuits. Normally, available returns from CCA can be withdrawn at any time and are partly protected from creditors and lawsuits. The more people add to CCA principal, the stronger the CCA system will be in the long run, because the principal is turned over to the next generation of CCA holders at death. Therefore, we should look for ways to encourage people to make additions to CCA principal. However, we wouldn't want them making additions to CCAs simply to avoid creditors, lawsuits, assessment for back taxes, and so on. If people were willing to deposit money into CCA principal without receiving the protection from creditors for that portion of the principal, I see no reason for any limits to additions. Limits should be only for the amount that can be added and remain available and/or protected from creditors and other seizures. More work will have to be done

to consider the best rules, but I think it should be done on the basis of searching for the best way to incentivize people to add as much as possible to the principal without giving them unfair protection against creditors. I think a good policy might be that X percent of every deposit into a CCA becomes part of the principal. I don't have room for a more thorough treatment here, but I think an investigation of appropriate rules would be a fun paper to write.

#### NOTES

1. Widerquist and Howard 2012c.
2. Widerquist and Howard 2012c.
3. Widerquist 2007; 2010; 2011.
4. This was during a break after I had presented the draft at the US Basic Income Guarantee Network conference at the Eastern Economic Association a few years ago.



## PART IV

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### Conclusion



The Alaska Model as a  
Menu of Options

*Karl Widerquist and Michael W. Howard*

This book has provided a broad discussion of the possibilities for adapting the Alaska model, as we have defined it, to work in other times and places. Authors have not examined every nation and region of the world, far from it, but the discussion has examined developing nations, developed nations, newly resource-rich areas, long-term research-rich areas, and resource-poor areas. Therefore, we hope that this book provides a wide set of examples from which nearly any nation or region of the world can draw useful lessons about how the Alaska model can be adapted for their circumstances. This chapter reviews the contributions of each chapter and discusses the menu of options available for applying the model in different places and times.

Hamid Tabatabai shows how Iran has introduced something even closer to a basic income than the Alaska dividend. The Iranian legislation was introduced as a compromise to replace inefficient subsidies, with very little discussion of either the theory of basic income or the practice of the Alaska dividend. But the very fact that this model can come out of such a compromise demonstrates its flexibility and applicability.

Angela Cummine addresses the skepticism among managers of Sovereign Wealth Funds (SWFs) around the world about Alaska-style resource dividends, and shows that much of it is based on misconceptions or unclear reasoning.

Alanna Hartzok adds a word of caution about the current management of the Alaska Permanent Fund (APF). She argues that

before we consider employing this strategy on a global basis, it needs to live up to more rigorous ethical standards. We agree that the APF and the accompanying Permanent Fund Dividend (PFD) can be improved, but we believe that the Alaska model is an enormous step forward already, and that it is worthy of both imitation and improvement.

Cliff Groh shows that Alaska faces difficult times ahead as oil revenue declines as exports continue to drop—as they inevitably will. He is right, but it must be stressed that this difficulty is caused by the failure of the state to employ the model more fully and more widely. The APF and PFD are financially sound and prepared for the day when oil runs out. It is the rest of the state budget—living off oil revenue that is known to be temporary—that is the problem.

Chapters in Part II provide proposals for adapting the model to specific circumstances. Gary Flomenhoft considers the economically well-off but resource-poor state of Vermont. Paul Segal considers a worldwide resource dividend. Jason Hickel considers the economically poor but newly resource-rich state of South Sudan. Former Alaska governor, Jay Hammond, in a posthumous contribution written several years ago, considers how the Alaska model could be employed to help strengthen and unify Iraq. Michael W. Howard considers the cap-and-dividend proposal as a politically feasible way to employ the Alaska model in the United States as a whole.

In the final two chapters of Part II, Karl Widerquist first suggests how the United States can create a permanent, common-asset-based endowment, large enough to fund a significant portion of the federal government budget. He then considers the extent to which Alaska could have converted, or can still convert, its temporary resource-revenue stream into a permanent resource endowment to prepare for the eventual decline in oil exports.

All the chapters in Part III discuss Widerquist's proposed variation on the Alaska model, individualizing the APF and PFD combination into Citizens' Capital Accounts (CCAs). This proposal is meant to create a policy in between basic income and stakeholder grants, capturing some of the benefits of both. Howard criticizes the CCA proposal for its slow phase-in and considers how to introduce the idea more quickly. Jason Berntsen criticizes the argument for CCAs in two ways, one based on paternalism and one based on property rights. Ayelet Banai considers the feasibility of applying CCAs in Iraq, in general, and in Iraqi Kurdistan, in particular. Christopher L. Griffin, Jr. addresses the specific issues of parental withdrawals and additions

to their children's CCAs. In the final chapter of part III, Widerquist responds to all of these comments.

After reading all these ambitious proposals, readers of this book probably have the sense that a wide menu of options is available for adapting the Alaska model for different places, times, and circumstances. We will conclude with a summary of some of the available options for employing the model in incremental as well as ambitious ways. The menu we present is more illustrative than exhaustive.

Several choices define the dimensions of the menu of options. Such choices are often called social choices, because the answer affects the whole of society regardless of who makes the choice. We will assume that the government makes these choices, because it has ultimate legal authority over them no matter how they are made. Out of the thousands of decisions governments make, three of them define what we call the Alaska model.

Choice 1. The government has to decide whether to capture rent on privatized resources or give them away. Government can temporarily capture rent by selling a resource, or they can permanently capture it by renting the resource. Of course, they can also give resources away with a tax liability attached. We have not explored the difference between renting a resource and giving it away subject to a tax liability. Even if there are meaningful philosophical differences between the two, their effects on rent capture are likely to be similar. The relevant choice is in the continuum from not charging for privatized resources at all to taxing or renting them at 100 percent of their market value.

Choice 2. The government has to decide whether to create a permanent endowment or not. As discussed in earlier chapters, many resource taxes produce permanent revenue streams, and thus they function as permanent endowment automatically in ways that income, sales, and property taxes do not.<sup>1</sup> If a resource tax is in place, the permanent endowment issue is crucially important only for nonrenewable resources, such as oil, because they produce temporary revenue streams. The main question becomes what portion of a temporary resource windfall should be put toward the creation of an endowment. Governments could create endowments through means unrelated to resources or common assets, but we haven't discussed this issue.

Choice 3. The government has to decide whether to have a dividend and what portion of its revenue to devote to it. Of course, governments make thousands of budget decisions, but the relevant trade-off

for this project is between a dividend (or some similar mechanism) and all other government spending.

The Alaska model, as we have defined it, means that at least some privatized resources are rented or taxed, at least some of that revenue is used to create a permanent endowment, and at least some of the returns to that endowment are directly distributed to the people via a dividend or some similar mechanism. Thus, the government can make very different decisions on each of these three issues and still in some way follow the Alaska model. We can say that the Alaska model is more fully employed, the greater portion of resource rent the government captures, the larger and more permanent its endowment, and the larger its dividend.

Three more social choices, closely related to the three above, broaden the menu of options much further, determining how the government will employ the model and work it into the existing government system.<sup>2</sup>

Choice 4. The government has to decide how large its budget should be.

Choice 5. Closely related, the government has to decide where to get its revenue. For our purposes, the relevant question is what portion of government revenue will come from common assets, on one hand, and all other taxes, on the other.

Choice 6. If the government decides on direct distribution, it has to pick a method, which could be an irregularly sized year-end bonus, like the Alaska dividend; a regular basic income; a once-in-a-lifetime stakeholder grant; a CCA; or something else. These options are clearly laid out in almost every chapter above and in our previous book,<sup>3</sup> and so we won't review them here. However, we should mention that we do not consider Social Security, unemployment insurance, and other forms of conditional social assistance to be direct distribution. Although programs such as these are often extremely valuable, they are not unconditional payments to all citizen residents. We take this feature of the PFD to be an essential characteristic of the Alaska model.

Now that we have defined the choices available, we can consider some of the menu options. The interaction between these decisions makes the menu very complicated. How large one believes total government spending should be might affect the type of taxes one prefers, and so on. We don't try to list the menu options. Any such list would be misleadingly incomplete. Instead we will discuss some existing and theoretical options, as well as some points of controversy.

The status quo in most countries today involves few, if any, aspects of the Alaska model. Most privatized resources have been given away

for free, and more is taken from the commons daily. Direct resource taxation is extremely rare. Even the “property tax,” which sounds like a resource tax, mixes the value of improvements with the value of the resources themselves, causing negative side effects.<sup>4</sup> As Flomenhoft demonstrated in his chapter, taxes typically capture only a small portion of common asset rents. Although our distant ancestors had access to a world full of common resources, few of us received any compensation for all the property that has been assigned to others. Instead, there is poverty and economic insecurity, inadequately alleviated by a bureaucratic, dysfunctional, and intrusive welfare system. Many private sector jobs pay poverty wages and promise little hope of advancement.

Oil is a rare exception to the rule of resource giveaways. It is one of the few commodities for which governments usually try to get some revenue in exchange for privatization. Most governments, including Alaska’s, have fallen far short of maximizing profits from their oil reserves, but a few others, such as Norway’s and those of several Persian Gulf nations, have successfully captured most oil rents, sometimes for the people, sometimes for the ruling family.

Alaska—as earlier chapters have made clear—is so far the only place that employs all three elements of the Alaska model. It does each one in a partial way, and both Groh and Widerquist worry it has not done enough to turn its temporary resource revenue into a permanent endowment.<sup>5</sup> We have similar worries about most other states currently undergoing resource booms. As Widerquist argued in this volume, no nation can be sure it has escaped the resource curse until resource exports are gone.<sup>6</sup> A more fully employed version of the Alaska model, even in Alaska, could help protect these countries from the pains of declining resource exports.

Iran’s new dividend program is closer to the basic income model than Alaska’s, but Iran seems to be less well prepared for the eventual decline in oil exports than Alaska. Of all the countries currently undergoing a major resource boom, Norway might be the best prepared for the eventual decline of resource revenues. It has extracted a very high portion of the rental value of its oil fields and put it to good use.<sup>7</sup> Norway lacks a universal dividend like the PFD, but it has good government services, good infrastructure, and a relatively large SWF.

However, Norway had major advantages before it discovered oil, and it could still do much more to create a permanent resource endowment.

Discussion of a more fully employed Alaska model moves out of existing practice and into theory. Several theoretical models have been discussed in this book and its paired book released earlier.

Left-libertarianism is one theoretical model that has a close connection to parts of the Alaska model. Left-libertarians argue for the moral superiority of taxes on resources and other common assets over all other forms of taxation. Some left-libertarians go so far as to argue that the government has a moral duty to tax common assets up to their full rental value *and* a moral duty *not* to tax anything else. Left-libertarians differ among themselves on dividends.<sup>8</sup> Some are very favorable toward dividends or basic income, but others would prefer to use the whole endowment for government spending, which might include more traditional forms of redistributive spending. Many left-libertarians are committed to the empirical claim that taxes on common assets are capable of supporting all government spending.

One does not have to be committed to these left-libertarian claims to be sympathetic to the Alaska model. The findings of these two books indicate that the ethical case for taxing resources is at least as good and perhaps better than taxing other things and that the efficiency benefits of a permanent resource endowment are very strong. Therefore, there is good reason for people of all political ideologies to consider taxing resources before taxing other things. Because so few governments tax resources at all, there is enormous potential to shift taxes in that direction.

Few other political ideologies are morally committed to any particular kind of tax. Property rights advocates or right-libertarians prefer a minimal *level* of taxation, but they also believe that, to the extent that taxation is necessary, it should be collected in the most efficient and least disruptive way. Thus, we believe that even right-libertarians should seriously consider the Alaska model. At least one right-libertarian has attempted a favorable introduction to resource taxation for property rights advocates.<sup>9</sup>

Progressive ideologies, such as Liberal-egalitarianism, Civic Republicanism, Communitarianism, and so on, usually support a more active government and are more favorable to a high level of taxation. Liberal-egalitarians who support basic income have usually assumed it would be supported by a progressive income tax. Progressives tend to be skeptical about the left-libertarian reluctance to tax anything besides resources, and about the left-libertarian claim that resource revenue can support all government spending, but they have no necessary reason to oppose raising what revenue they can from a resource endowment. Therefore, we believe, adherents of many different political ideologies should be interested in the Alaska model, although they would choose different options about the level of taxation and the mix of spending.



Widerquist, in chapters 11 and 12, suggested splitting the returns to the permanent endowment: half for government expenses, and half for a dividend. He argues that if the endowment turns out to be large enough, there would be need for few other taxes.

Jay Hammond preferred a larger APF devoted entirely to supporting the PFD. Other taxes, such as the state income tax, should remain in place at least in part because tax-linked spending gives citizen taxpayers a stronger incentive to be vigilant against wasteful or counterproductive government spending. From this conjecture, we can create an alternative model, we'll call "the Hammond model," in which the government creates the largest permanent endowment it can through capturing rents on common assets. The endowment's returns are devoted entirely to supporting a dividend, and all other spending is supported by the income tax (or whatever form of taxation is most prudent). One could even imagine a new political ideology in between left- and right-libertarianism called "Hammondian-libertarianism," combining the highest sustainable resource dividend with the lowest necessary level of income taxes. This ideology probably does not exactly mirror Hammond's beliefs, but he would probably recognize his influence over Hammondian libertarianism.<sup>10</sup>

One might prefer to go in the opposite direction, using resource revenue entirely to replace existing taxes without distributing any of it as a dividend. If it is a good, efficient source of revenue, it can simply replace other taxes. We are skeptical about this strategy on its own, partly because using revenue from newly privatized common assets to replace income taxes is regressive: it helps only the rich and does nothing for the poor. If there is a tax shift from income taxes to taxes on previously privatized assets it is not likely to be regressive, because resource ownership is as unequal as income (perhaps more). A direct dividend for all citizens is far more progressive than most forms of tax cuts and more progressive than most other things the government is likely to do with the resource revenue.

Hammond's experience with the elimination of Alaska's income tax illustrates a problem. In a political compromise, he agreed to use most of Alaska's oil revenue to replace the state's income tax, but he later regretted this decision, not only because the oil revenue the state was choosing to run on was temporary, but also because he thought it was an unfair way to share the benefits of the state's newfound income.

To see the disparity, imagine a state with 1 million people and 1 million dollars of new resource revenue. If the state shares that new revenue through a dividend, each citizen benefits by the same

amount: \$1. If it shares that new revenue through an income tax cut, low-income people gain nothing, middle-income people gain very little, and upper-income people receive almost all the gains because they pay the most income taxes.<sup>11</sup> Thus, progressives should be very concerned about using resource revenue for anything but a dividend at low levels of resource revenue.

This concern loses force, however, when the size of the resource revenue is large and when we are shifting from existing income taxes to taxes on already privatized, but untaxed, resources. Resources, especially income-producing resources, are very unequally owned, and resource taxes might turn out to be as progressive as income taxes (as well as being easier to collect and less burdensome on taxpayers). If Flomenhoft's higher estimates for the value of resource rents turn out to be correct, a resource-endowment could fund both a very high basic income and a significant portion of other government spending.

Many options are now on the table. The Alaska model, as we see it, is a framework that can improve the effectiveness and efficiency of governments with very different ideological characters and in very different economic circumstances. The right answers to all the choices discussed above depend both on ideological and practical concerns. We believe this book has made a strong case that there is good reason, almost regardless of ideology, to move in the direction of the Alaska model. Almost everywhere today governments are missing opportunities to reduce burdensome taxes and to create sustainable public endowments. In the course of doing so, they might also reduce poverty and increase economic equality and opportunity. The Alaska model is efficient, fair, and environmentally friendly. Citizens and policy makers everywhere should examine it carefully and adapt it to fit their particular circumstances.

#### NOTES

1. In this volume, see Hartzok, chapter 4; Flomenhoft, chapter 6; and Widerquist, chapters 11 and 12.
2. We have left out thousands of related choices, including, for example, the choice of what portion of resource to hold in common and what portion to privatize. The arguments here pertain mostly to privatized resources.
3. Widerquist and Howard 2012a.
4. Maxwell and Vigor 2005.
5. Groh, this volume, XXX; Widerquist, chapter 11, this volume, XXX.
6. Widerquist, chapter 12, this volume, XXX.

7. Warnock 2006.
8. Vallentyne and Steiner 2000a and 2000b; Reeve and Williams 2003; Widerquist 2009.
9. Pollock 1996.
10. For skepticism about combining a dividend with an income tax in Alaska, see Groh, this volume.
11. Howard makes a similar point when defending a carbon dividend against proposals for using carbon cap revenues for government spending.



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## CONTRIBUTORS

**Ayelet Banai** (Banai@soz.uni-frankfurt.de) is a research fellow at the Centre for Advanced Studies “Justitia Amplificata,” the University of Frankfurt, Germany. She holds DPhil (PhD) in Political Theory from the University of Oxford and MA in Political Science from the Hebrew University of Jerusalem. Her research and publications are in international political theory, including the right to self-determination and democracy and democratization in Europe and the Middle East. She is coeditor, of the volume *Social Justice, Global Dynamics: Theoretical and Empirical Perspectives* (Routledge, 2011).

**Jason Berntsen** (jberntse@xula.edu) is an assistant professor in Philosophy at Xavier University of Louisiana. He received his PhD from the University of Missouri-Columbia after defending a dissertation on the topic of moral noncognitivism. He is the author of “Emotivism and Inconsistency” (forthcoming in *Southwest Philosophical Studies*) and “Why Physicalists Needn’t Bother with Perry’s Recent Response to the Knowledge Argument” (*Southern Journal of Philosophy*, 2004).

**Angela Cummine** (angela.cummine@new.ox.ac.uk) is an Australian Rhodes Scholar completing her PhD in Political Theory at New College, Oxford, on the justice issues surrounding Sovereign Wealth Funds (SWFs). She has worked at the Australian Department of the Prime Minister and Cabinet in Canberra as a policy officer and is currently a research consultant for the Future Fund (the Australian SWF) and for the International Forum of SWFs. She also worked for the OECD in the International Investment Division monitoring investment openness in recipient countries. Her research on the potential of SWFs to fund basic income dividends won the 2011 *Basic Income Studies* Essay Prize and appeared in the journal *Basic Income Studies*. Her SWF research has also appeared in the *Sydney Morning Herald* and in the Oxford SWF Project Blog; it has been cited in the *Economist*, the *Financial Times*, and the *New York Times*.

**Gary Flomenhoft** (Gary.Flo@uvm.edu) is a fellow at the Gund Institute for Ecological Economics and a lecturer in Public Administration at the University of Vermont. He directs the Vermont Common Asset Trust project and is editor of *A Green Tax Shift for Vermont* (2009) and coeditor of *Valuing Common Assets for Public Finance* (2008).

**Christopher L. Griffin, Jr.** (christopher.griffin@aya.yale.edu) is an assistant professor at the William & Mary School of Law. From 2010 to 2012, he was a visiting assistant professor of law at Duke University School of Law. A graduate of Yale Law School, he served as an editor of the *Yale Law Journal* and editor in chief of the *Yale Law & Policy Review*. His empirical law and economics work has been published in the *Utah Law Review* and in the *Journal of Empirical Legal Studies*.

**Cliff Groh** (cliff.groh@gmail.com) is an attorney and writer in Anchorage, Alaska. He was the principal legislative assistant working on the legislation adopted in 1982 that created the Permanent Fund Dividend that Alaska has today. He also served from 1987 to 1990 as the special assistant to the Alaska commissioner of revenue. A lifelong Alaska resident, Groh has organized, presented at, and/or moderated at more than a dozen events regarding Alaska fiscal policy over the past two decades. He was a delegate to the Conference of Alaskans in 2004.

**Jay Hammond** (1922–2005) whose contribution to this book has been included posthumously, was governor of the State of Alaska from 1974 to 1982. He has been justly described as “the father of the Permanent Fund Dividend.” He promoted the idea of a dividend-paying sovereign wealth fund well before he became governor and until the end of his life.

**Alanna Hartzok** (alanna@earthrights.net) is codirector of Earth Rights Institute and author of *The Earth Belongs to Everyone*, and recipient of the Radical Middle Book Award. She is a United Nations NGO representative, an officer of the International Union for Land Value Taxation, and on the International Advisory Council for the PROUT Research Institute of Venezuela. Her 2001 E. F. Schumacher Lecture was published as *Democracy, Earth Rights and the Next Economy*. That same year she was a candidate for Congress in the Ninth District of Pennsylvania. She currently administers a distance learning course and training program—Land Rights and Land Value Capture—that now has over 700 registrants from 95 countries. She advises course graduates and land administrators on land rent for

public revenue policy implementation projects. Website: [www.course.earthrights.net](http://www.course.earthrights.net)

**Jason Hickel** ([jasonhickel@gmail.com](mailto:jasonhickel@gmail.com)) is a postdoctoral fellow in Anthropology at the London School of Economics and Political Science. He received his MA and PhD from the University of Virginia for research on democracy, violence, and political conflict in South Africa, and his present interests extend to development, globalization, labor, and economic policy in Africa. His most recent articles have appeared in *History & Anthropology*, *Anthropological Quarterly*, *Journal of Southern African Studies*, *South African Historical Journal*, and *Anthropology of This Century*. In addition to his academic work, Jason contributes commentary and analysis to various online magazines, including *Al Jazeera*, *Foreign Policy in Focus*, *The Africa Report*, *New Left Project*, and *Monthly Review*. Jason is the grandson of former Alaska governor Wally Hickel, who championed the Owner State model and the cause of the commons. He has worked to adapt aspects of the Owner State model to various African contexts, including Sudan, Uganda, and Nigeria.

**Michael W. Howard** ([michael.howard@umit.maine.edu](mailto:michael.howard@umit.maine.edu)) is a professor in the Department of Philosophy at the University of Maine, and the national coordinator of the US Basic Income Guarantee Network. He is the author of *Self-management and the Crisis of Socialism* (Rowman & Littlefield, 2000), and the editor of *Socialism* (Humanity Books, 2001), and has published numerous articles on basic income, environmental justice, and other topics in social and political philosophy.

**Paul Segal** ([P.Segal@sussex.ac.uk](mailto:P.Segal@sussex.ac.uk)) is a lecturer in Economics at the University of Sussex and a senior visiting research fellow at the Oxford Institute for Energy Studies. His research concerns the economics of resource-rich countries, and global poverty and inequality, and recently he has focused on the distribution of natural resource revenues. He also writes occasional articles on macroeconomic policy in the popular press. He has been a research fellow at Harvard University and a consultant economist at the United Nations Development Programme.

**Larry Smith** ([lestate@gci.net](mailto:lestate@gci.net)) is the coordinator of Kachemak Resource Institute, which published Jay Hammond's book *Diapering the Devil*.

**Hamid Tabatabai** ([hamtab@gmail.com](mailto:hamtab@gmail.com)) was a senior economist at the International Labour Office, Geneva, Switzerland, until his retirement in 2010. His main areas of work related to employment,

poverty, income distribution, child labor, and cash transfers. He did his postgraduate studies at the London School of Economics and at Cornell University, Ithaca, New York, where he obtained a PhD in economics in 1982. He is an Iranian and lives in France.

**Karl Widerquist** (karl@widerquist.com) is an associate professor in political philosophy at the Georgetown University School of Foreign Service in Qatar. He holds two doctorates—one in Political Theory from Oxford University (2006) and one in Economics from the City University of New York (1996). He is coeditor (with Michael W. Howard) of *Alaska's Permanent Fund Dividend: Examining its Suitability As a Model*. He is coauthor (with Michael A. Lewis) of *Economics for Social Workers* (Columbia University Press), coeditor (With Michael A. Lewis and Steven Pressman) of *The Ethics and Economics of the Basic Income Guarantee* (Ashgate), and coeditor of *Basic Income: An Anthology of Contemporary Research* (Blackwell, forthcoming). He is a founding editor of the journal *Basic Income Studies*, and he has published scholarly articles on economics, politics, and philosophy in journals such as *Political Studies*, *Utilitas*, *the Eastern Economic Journal*, *Politics and Society*, and *Politics, Philosophy, and Economics*.

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