

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

January 26, 2016
9:00 a.m.

MEMBERS PRESENT

Senator Bill Stoltze, Chair
Senator John Coghill, Vice Chair
Senator Charlie Huggins
Senator Lesil McGuire
Senator Bill Wielechowski

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 128

"An Act relating to the Alaska permanent fund; relating to appropriations to the dividend fund; relating to income of the Alaska permanent fund; relating to the earnings reserve account; relating to the Alaska permanent fund dividend; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PRESENTATION: Making Appropriations from the Permanent Fund/Permanent Fund Dividend

- HEARD

PREVIOUS COMMITTEE ACTION

BILL: SB 128

SHORT TITLE: PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

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|----------|-----|---------------------------------|
| 01/19/16 | (S) | READ THE FIRST TIME - REFERRALS |
| 01/19/16 | (S) | STA, FIN |
| 01/26/16 | (S) | STA AT 9:00 AM BUTROVICH 205 |

WITNESS REGISTER

CRAIG W. RICHARDS, Attorney General

Alaska Department of Law
Juneau, Alaska

POSITION STATEMENT: Provided an overview of SB 128.

MALAN RIETVELD, Fellow

Center for International Development at Harvard Kennedy School,
Cambridge, Massachusetts

POSITION STATEMENT: Provided an overview of sovereign wealth funds as it pertains to SB 128.

ACTION NARRATIVE

[9:00:48 AM](#)

CHAIR BILL STOLTZE called the Senate State Affairs Standing Committee meeting to order at 9:00 a.m. Present at the call to order were Senators Wielechowski, Huggins, McGuire, Coghill, and Chair Stoltze.

SB 128-PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS

[9:01:28 AM](#)

CHAIR STOLTZE announced the consideration of SB 128. He detailed that SB 128 is the governor's initiative regarding appropriations from the Permanent Fund earnings and dividend to address the state's fiscal crisis.

[9:03:11 AM](#)

At ease.

[9:04:23 AM](#)

CHAIR STOLTZE called the committee back to order.

[9:04:30 AM](#)

CRAIG W. RICHARDS, Attorney General, Alaska Department of Law, Juneau, Alaska, announced that the administration's presentation focuses on the theory of sovereign wealth funds (SWF) and how Alaska's SWF would operate within the SWF system as well as its advantages and disadvantages relative to other SWFs.

CHAIR STOLTZE asked Attorney General Richards to lay out his vision of SB 128 in order to assist the public as much as the committee members.

ATTORNEY GENERAL RICHARDS explained that SB 128 does the following:

1. Creates a way for Alaska to transition from a budget that is 90 percent based on oil revenues to a budget based on financial assets. SB 128 places the royalties and production taxes that the state receives every year into the Permanent Fund and draws \$3.3 billion. The goal is to provide a long term, stable source of financial revenues to the state on an annuity basis.
2. Changes the way the Permanent Fund dividend is calculated so that rather than having dividends based on the Permanent Fund's stock market returns and earnings, dividends would reflect the financial health of the state by making dividends based upon royalties.

[9:06:18 AM](#)

CHAIR STOLTZE asked Attorney General Richards to provide the committee with the Mr. Rietveld's background.

ATTORNEY GENERAL RICHARDS explained that Mr. Rietveld and his team has a consulting and academic background in advising oil dependent nation-state and provincial clients on SWFs. He detailed that SWFs allow oil-dependent states to transition away from budgets that are based on boom-bust oil-price cycles. He revealed that Mr. Rietveld and his team recently advised Saudi Arabia on transitioning to a rule-based SWF. He said the administration determined that designing an efficient and sustainable SWF using the Permanent Fund required the assistance from Mr. Rietveld, one of the world's foremost experts on designing rule-based frameworks around a SWF. He stated that the hope is Mr. Rietveld can pass his knowledge on to the committee as well.

CHAIR STOLTZE thanked Attorney General Richards on behalf of the public. He addressed Mr. Rietveld and asked if he was an employee or graduate.

[9:09:53 AM](#)

MALAN RIETVELD, Fellow, Center for International Development at Harvard Kennedy School, Cambridge, MA, explained that he is a "fellow" at the Harvard Kennedy School, which means he is an unpaid researcher. He noted that he worked with a particular team at the Harvard Kennedy School called the Center for International Development, a team that does a lot of work with resource rich, resource-dependent countries, states, and provinces around the world. He noted that the Center for International Development consists of people with a lot of practical experience, including former finance ministers of oil-

rich countries. He revealed that he has been studying SWFs for more than a decade, has worked on a couple of edited volumes published by university presses, and has written a number of SWF reports.

9:11:09 AM

SENATOR WIELECHOWSKI asked that Mr. Rietveld discuss his background.

MR. RIETVELD detailed that he was an economics graduate and recently finalized his PhD on the topic of SWFs. He noted that he worked in asset management within the investment management industry for four years. He added that although he was currently a Harvard Fellow, he also consulted with governments on SWF issues, especially big ones in the Middle East. He revealed that he has worked with U.S. states on permanent funds, SWFs in Latin America, and a whole bunch of countries looking to introduce legislation to create SWFs. He summarized that SWFs are his particular area of expertise within the field of economics, but he also looks more generally at issues around the management of resource revenues.

CHAIR STOLTZE quipped that Mr. Rietveld's PhD dissertation might be "How I fixed Alaska's economy."

MR. RIETVELD replied that he was not sure if he had all of the solutions, but Alaska's circumstances were very interesting from a comparative perspective. He set forth that Alaska has a number of comparative strengths and an interesting case with a lot of best-practice ingredients that will help in transitioning towards a system that helps the state cope with some tough environments.

9:12:51 AM

He detailed the growth of new SWFs as follows:

The number of SWFs has really proliferated, particularly since the 2000s, driven, I think, in large part from the resources boom, both in terms of prices and in terms of new producers, globally. Some SWFs have certainly grown in number and they have grown very significantly in the size of assets under management of the existing funds as well. One of the big drivers has been the commodity-revenue boom since roughly 2003. In some case there are SWFs that don't manage natural resource revenues per se, but other kinds of government surpluses whether it is proceeds

from a privatization or other appropriated fiscal surpluses; but, the overwhelming majority of SWFs are funded by resource revenues and that's what almost all of my remarks today will pertain to.

Just as we are talking about definitions and concepts, I think it is important, this whole issue of "sovereign." Of course Alaska is not sovereign, but I use the term "sovereign wealth fund" and most people in literature would use "sovereign wealth fund" to describe state funds and provincial funds like the Canadian province of Alberta Heritage Fund, the Alaska Permanent Fund, the Wyoming Permanent Fund and other sub-national funds owned and managed by sub-national jurisdictions. So I don't want the use of the word "sovereign" in the title to be misleading. I definitely, for the purposes of this discussion, certainly include the Permanent Fund in that category of definitions of SWFs.

[9:14:52 AM](#)

MR. RIETVELD addressed three-SWF categories as follows:

In the first instance for resource-rich countries there is "stabilization funds;" these are essentially highly liquid buffer-funds the intention of which is not to grow the asset base, but rather to be able to draw on the assets when you need to in a very short term manner and those rules might be rule-based or discretionary. I certainly have a preference for a rule-based system, but the defining characteristic of them relative to the other funds is that they are largely sitting on fixed income and cash securities and it's not controversial when they are drawn upon heavily in times like this and the idea is to restore them in boom periods.

The second category that I would identify is what I would call "savings funds," these are also often called "future generations funds" and here the asset allocation is very different. The fund's portfolio is orientated towards growth and a decent amount of risk exposure in order to generate high returns that funds some kind of earmarked liability in the future. So the Australian SWF, the New Zealand SWF or such funds, they have a target date of 2030 and 2035 I believe respectively, and the idea is that their funds are

supposed to just grow, they have no liabilities to them and the government wants to grow this pot of money to help meet an anticipated pension liability a decade and a half, two decades down the road. So the defining characteristic there is that these funds don't have a draw component to them.

The overwhelming majority of funds however are what I would call "investment income funds," of which the North American permanent fund is a prime example. The asset allocation is relatively risk exposed and the idea is to grow the corpus of the fund and certainly to protect the corpus of the fund from drawdowns and in the case of North American permanent funds is normally embedded in the constitution as it is here, which is a very positive and important institutional characteristic which I'll come to later in the presentation of things that I like about the Alaskan scenario. But these funds the defining characteristic is that they do have an annual draw and best practice is to have a fixed-amount draw based on what you think is a sustainable return for the fund in real terms so that grows the capital of the fund through inflation, or some notion of a percentage of market value, or a target return or observed past return. But in broad strokes the point is these funds, while the capital is there for current and future generations, their defining characteristic is they provide a stream of financial income in the form of financial returns to help fund governments and they are particularly popular in resource-based countries and jurisdictions as a way to offset dependence on commodity revenues.

[9:17:59 AM](#)

MR. RIETVELD noted that SWFs were very established and addressed the growth of new SWFs as follows:

The oldest SWFs in my definition is the Texas Special Schools Fund, now called the Texas Permanent Schools Fund, which was created in 1850 in Texas as part of the process that led to Texas' statehood from federal-land grants and there's a related Texas fund that funds the university system, they are the oldest funds. But what I'd like to draw attention to is the proliferation of funds since the 2000s and this is just the number of funds, not the assets they manage, just a number of new funds created in these decades

and it's quite striking that the growth period of the past 15 years has been significant. The other significant growth period was the late 1970s with the commodity-price boom then and the start of new production as it was in the State of Alaska.

9:19:08 AM

MR. RIETVELD addressed the context of major-global trends as follows:

Having defined and sort of categorized very broadly the SWF world, I'd like to talk about the broad trends that I observe studying SWFs and certainly working with them fairly hands-on. If I have one overarching message, particularly for the resource based SWFs, it's that the attention now is on the fiscal framework around SWFs. What do I mean by that? I mean that in the past the focus was perhaps on simply the creation of the funds, the legislative process, or otherwise if it's more of an autocratic system of how do you establish this fund, how do you create this fund that carves out revenues and resources out of the budget, and that was the emphasis and that was the struggle and the process that had to go through.

Given that SWFs are now fairly well known and widely regarded as state-of-the-art in terms of how to manage resource revenues, the emphasis is now moving more towards how do we improve upon our rules that lead to how money flows into these funds and in the case of investment-income funds and stabilization funds, how the money flows out in a rule-based way, in a predictable way, and in a transparent and fair way. That's the shift and I can say that particularly in resource-based countries, every single country in the world is going through this and every single state and province that is resource-dependent or resource-rich and has a SWF is going through this. Everybody is going through it in a different way given their different legal context, political context, their existing institutional infrastructure; but, Alaska is by no means alone in this and in many ways I think at the vanguard in taking appropriate and early action to try and adjust to the new realities.

9:21:08 AM

MR. RIETVELD stated that he identifies the three-distinct SWF stages as: SWF 1.0, SWF 2.0, and SWF 3.0. He described the SWF stages as follows:

The past decade has been a period of SWF 2.0 and I think we are transitioning to SWF 3.0. SWF 1.0 was the very-early stage in which the very-early adopters of the SWF model emerged as I mentioned: Texas in the 1850s, followed by New Mexico. Then in the 1970s a whole bunch of Middle Eastern countries: Saudi Arabia, Kuwait, Abu Dhabi, a little bit later Qatar; Alberta, and Alaska. Here the emphasis was on creating these funds, it was very much dominated by resource-rich countries and the investment model was very simple. The overriding purpose was to cut out a share of revenues from the budget process and park it somewhere. Consequently the investment models were very simple, it was largely deposited in bonds and cash securities without a huge amount of attention paid to the portfolio and the characteristics of the portfolio itself.

SWF 2.0 emerged at the turn of the century where we saw, as I have already mentioned, significant growth in the number of funds, significant growth in the size of assets managed by these funds, driven by commodity revenues in the case of Asian countries, driven by trade surpluses and privatizations. The funds also grew, not just by their funding sources, but also by fairly healthy financial returns over this period since the Asian financial crisis in 1998 to 2014. With the exception of the collapse of Lehman Brothers, it was a period of high and fairly steady financial returns which also buoyed the size of these funds.

[9:23:11 AM](#)

He addressed the SWF model going mainstream as follows:

The important thing to understand about this period is that it really led to the idea of a SWF model going fairly mainstream, so it now sits in the International Monetary Fund's recommendations of best practices for any resource-rich country to have a SWF, to transform its resource wealth and resource income into some form of financial wealth. This is absolutely standard practice and at the IMF it's one of the first things they mention when they go visit any resource-rich

country that reports to them, it also led to the creation of something called the International Forum of Sovereign Wealth Funds, of which the Permanent Fund is a member; they meet annually and it includes roughly 40 of the world's largest funds. Very few funds now are not participating in that forum, they do a bunch of things, most important of which they have come up with a set of 24 principles and practices for the governance and management of these funds. There's no doubt in my mind that the Alaska Permanent Fund is sort of best-in-class among this group. I have very little doubt that the Permanent Fund would adhere to all 24 principles stated in the International Forum's principles of best practices.

The other point of the International Forum is that it is a platform for SWFs to meet, to exchange ideas around the management of their portfolios, to exchange ideas around the fiscal frameworks around them, and it's a way for the community to engage with each other, so Alaska's participation in this is I'm sure very beneficial and should be encouraged.

The final aspect of this era that has proceeded where we are today is that in earlier stages, SWFs tended to be fairly politically controversial and tended to be prone to raids on their capital in tough times, now that's less of an issue if your capital and corpus is constitutionally protected; but, in this most recent period I think some of those political pressures have been reduced worldwide as people understand the importance of these funds in managing medium and long term fiscal affairs.

[9:25:25 AM](#)

CHAIR STOLTZE noted that Mr. Rietveld referenced "political compromise" and "political pressure" when explaining SWFs. He asked what he meant by the two terms.

MR. RIETVELD explained that an example of "political compromise" would be when Wyoming raised taxes in 1976 on oil, gas and coal companies. He specified that Wyoming's compromise occurred when the added revenue was used to establish its permanent fund in order to benefit future generations rather than just cashing-in on a short-term commodity price-spike. He explained that he referenced "political pressure" when SWFs were formed during boom-periods that ultimately broke down in bust-periods due to

political pressure. He noted that political pressure is not an issue for Alaska's Permanent Fund due to its strong legal foundations.

CHAIR STOLTZE commented that he was glad to hear that Alaska was immune from the political pressure that Mr. Rietveld explained.

[9:28:22 AM](#)

MR. RIETVELD explained the end of SWF 2.0 as follows:

SWF 2.0 came to an end when commodity prices collapsed towards the end of 2014 and we all know about the steady and devastating collapse in global-oil prices in particular since then. For some SWF skeptics I imagine the question is now really whether SWFs and particularly the growth that we saw since the mid-2000s in SWFs will be sort of a historic-blip on the radar whether some of these funds will in the first instance be drawn down upon and the second instance whether they will actually be growing as was expected a few years ago when oil prices were still high; for me, that is not really called into question, I think the degree of consensus around the importance of SWFs, the many incidences right now, well designed SWFs are helping resource-dependent countries cope is significant and sufficient evidence for the SWF models appeal to remain intact. But what I do think is that the current era is about adjusting to the fiscal realities of SWFs.

He explained SWF 3.0 and the adjustment to the new-fiscal realities as follows:

SWF 2.0 was a period of rising-commodity prices, SWF 3.0 will be about coping with lower commodity prices. For resource-rich countries and what a lot of the rest of my presentation is all about is the need now to introduce what we academically call "cyclically robust" or "counter cyclical fiscal frameworks" and that's just a mouth full for saying we want fiscal frameworks that allow us to accumulate assets in the SWF in good times and we want sensible, sustainable policies for drawing on SWF assets and income in the tough times so that you have a policy that takes care as much for the boom-period of the cycle as it does for the bust-period of the cycle. Many rules that we see in place right now only do one-half of the story,

they only take care of saving some portion of the boom, so the emphasis is now on that second half of the equation. As you go through that, the two major concerns is how do you avoid the depletion of assets and I'll say again, unless it is constitutionally protected, you have less reason I think to worry about that.

[9:30:54 AM](#)

CHAIR STOLTZE stated that he appreciated Mr. Rietveld's parenthetic remarks pertaining to Alaska's constitutional protection. He said the constitutional protection was an issue for the committee to discuss. He opined that the constitutional protection appeared to be a stronger threshold than any.

MR. RIETVELD answered correct. He said the constitutional protection of capital is among the most firm and robust for SWFs, a strong and very positive feature.

MR. RIETVELD addressed the effect from the "ebbing tide" of commodity prices as follows:

I think big-picture what is also emerging from the SWF landscape as we deal with lower-commodity prices is that this "ebbing tide" has revealed that some countries have been swimming essentially naked as the ebbing tide sometimes does; their policies, while appropriate for the boom-period, are not necessarily right and robust to the tough times. So we are finding out which structures and which systems are equipped to handle the boom and the bust and which ones are more for the boom.

[9:32:24 AM](#)

He addressed SWF 3.0 and the world's adjustment to new fiscal realities by identifying three groupings as follows:

There is one group of countries and jurisdictions that are really hurting right now, group A, and they are the group that never managed to save at all or save enough of the resource-boom of the past decade and a half, and they are really approaching "basket case" status right now. Venezuela is the most obvious example, Nigeria and some other countries are in the same boat.

The second group of countries did manage to accumulate some amount of assets, you could argue about whether it was sufficient, whether they saved enough, but what they are going through right now is drawing down on their assets very heavily. Russia has drawn down on some \$150 billion, it's hard to know exactly because as you can imagine, the Russian system is not the most transparent one in the world, but they have drawn down on a huge amount of assets. Saudi Arabia likewise has drawn down on \$150 billion to \$200 billion in assets since we wrote our Harvard Report.

The third group of countries are the proactive ones who in the first instance saved a good amount of money in the previous boom and are now looking at if their spending policies and their withdrawal policies are appropriate and sustainable. I would put Abu Dhabi, Norway and Chile in that group with great certainty, Kuwait most likely, and Saudi Arabia if they were to follow our recommendations.

[9:34:35 AM](#)

MR. RIETVELD referred to a graph which plotted Alaska's fiscal dependence on oil and break-even price relative to other countries and states, and detailed as follows:

I've simply gone and said based on the share of oil revenue to the budget just prior to the slump, how much does oil account for total government revenue and on that metric? Alaska finds itself with a bunch of countries you would regard as petro-states: Abu Dhabi, Kuwait, Qatar; they are dependent of around 90 percent, of course that share drops when commodity prices drop, but in good times we are talking about governments that fund themselves for at least 90 percent on oil revenues.

He plotted the price of oil needed to balance budgets that prevailed before prices collapsed and addressed results as follows:

Alaska finds itself in rather uncomfortable territory to the extent that you needed \$110 a barrel to maintain the level of spending that proceeded before the price drop. What is striking to me is that Alaska finds itself on these two measures in the same territory as Saudi Arabia, which by itself is not good

news. There's a group of countries in the Middle East that I've plotted there: Kuwait, Qatar and Abu Dhabi, that while having the same degree of fiscal dependence on oil as Alaska does, is able to balance the budget with much lower oil prices and the simple reason for that is they have SWFs that can provide a stable source of income to supplement and offset the drop in oil prices. What I've basically indicated there is that in my assessment, if Alaska was to implement the SWF model to the full extent, you would be in that group and conceivably be slightly better off than that group for reasons I'll come to in a second. You could probably balance the budget with a \$40 to \$45 oil price if you made sensible and sustainable use of your financial assets. The other group of countries, provinces, and states that can balance their budgets at lower oil prices includes Wyoming, Alberta, and Norway; the advantage that these countries have is that they are way less dependent on oil, so for these countries oil accounts for roughly 30 to 45 percent of government revenues, so that's the other way out of this.

If you want to be able to adjust to a world of lower oil prices and balance the books, you either move towards a system in which you implement the SWF model, draw on the financial assets that you have accumulated in a rule-based sustainable manner, or you find other sources of revenue as Norway does, oil accounts for roughly a third of revenue and Norway has incredibly high personal-income taxes and corporate taxes.

MR. RIETVELD summarized that outside of the oil sector, Alaska does not have the economic and taxable base to cover the kind of holes it sees in its fiscal framework.

[9:38:43 AM](#)

He explained the economies of Alberta and Australia relating to oil dependency as follows:

Their discovery of oil essentially came on when they had really diversified industrial economies and large taxpayer pools that they could draw on so oil for them was a top-up on top of other established existing tax base, it's much harder if your economy is still largely oil dependent to introduce other forms of revenue creation.

CHAIR STOLTZE noted that South Korea has two companies that account for 33 percent of the country's gross domestic product and Alaska is at 90 percent for oil. He asked if any other province or sovereignty that has anywhere near Alaska's 90 percent.

MR. REITVELD answered that in terms of oil dependence, Alaska is right up there amongst the most oil dependent. He opined that the only places that are comparable are the Middle Eastern states. He specified that there is no doubt that Alaska is in the highest category of oil dependence worldwide where it's hard to imagine a greater share of oil accounting for revenue than it does in Alaska. He stated that he could have mentioned Venezuela and Nigeria, but Alaska is incredibly reliant on oil revenues based on its current infrastructure. He summarized that based upon the metrics of oil dependency and the oil price needed to balance the books under the status quo, the news was not good for Alaska.

SENATOR MCGUIRE pointed out that Venezuela, Nigeria and Russia were not included on Mr. Rietveld's oil dependency graph. She surmised that the exclusion was due to the countries not saving enough or depletion.

MR. RIETVELD pointed out that the countries noted on his graph had some form of SWF. He said Venezuela did not fit on the graph because the country required \$350 per barrel pricing.

[9:42:43 AM](#)

He stated that there was better news on the way for Alaska. He examined SWF assets that were relative to budgets and noted the following:

If you consider also just the size of SWF assets, it's easy to look around the world and look at Norway with its \$820 billion fund, Abu Dhabi with its \$775 billion fund, and Saudi Arabia with \$600 billion, and think that these funds sort of dwarf Alaska, and certainly in purely absolute terms, Alaska's Permanent Fund is considerably smaller. But I think the more pertinent point here is that what I do in the next slide is scale that same pool of capital held in the SWFs and scale it relative to budget and what I find there is that Alaska is the richest country in the world based on SWF assets; that is, Alaska's SWF assets and accumulated financial assets relative to its budget is

the highest in the world and I've quantified that by saying there is roughly 11 times the budget coverage in accumulated financial assets and Norway, which is a best-case example of how to manage SWFs in many people's books, isn't anyway near that, in fact, it's almost half of that, they've got about 6 times coverage of their annual budget in the form of their financial wealth.

There's no doubt to me that while there are problems for Alaska based on commodity dependence, based on the kind of oil prices you need to balance the budget, the big weapon in your arsenal is your financial wealth which is a direct consequence of your constitution, it's a direct consequence of prudence on part of past legislatures in terms of making sure that the fund is inflation-proof, historically it's a testament to the good management of the Alaska Permanent Fund over time, a whole bunch of factors. But the good news is at least you have the ingredients to a solution which many other countries don't have or at least don't have to the extent that Alaska has here.

[9:45:14 AM](#)

MR. RIETVELD addressed a sustainable draw as a percentage of budget as follows:

A similar sort of chart to the previous one is just to say if we were to apply a very standard, very uncontroversial idea of drawing 4.5 percent annually from those assets, so this is not I think in its entirety, the proposal on the table, but just to quantify the financial wealth. If you were to draw 4.5 percent per annum on that wealth, what percentage of the budget would that draw cover? Alaska is approaching 50 percent of the draw being able to be covered by what is a sustainable draw on those assets that would not jeopardize the real purchasing power of the Permanent Fund's capital; again, Norway is in a position where just slightly more than a quarter of their budget can be covered by a sustainable draw.

CHAIR STOLTZE asked Mr. Rietveld's if the 4.5-percent draw hypothesis takes inflation-proofing into consideration.

MR. RIETVELD answered as follows:

The 4 percent idea is something that sort of emerges from the financial planning literature for individuals, it's something that emerges from the university endowment literature, and the idea is that with the kind of portfolio you have in a SWF, or a university endowment, or a diversified financial portfolio, the return will exceed 4.5 percent by enough to offset inflationary pressures. So the nominal return, taking inflation into account, would be something like 6.5 to 7.5 percent, so that if you draw 4.5 percent, you're essentially making sure that you are not eroding the purchasing power.

CHAIR STOLTZE asked Mr. Rietveld to clarify that the mechanics of the fund will replace the mechanics of actual appropriations to inflation-proofing. He pointed out that the fund's mechanics will be a pivotal point for a lot of members.

MR. RIETVELD replied that he was addressing a notional concept rather than the fund's mechanics and would get to the dynamics of the fund later in his presentation.

CHAIR STOLTZE remarked that there was ambiguity about inflation-proofing and the committee would come back to the topic later in the presentation.

[9:47:59 AM](#)

MR. RIETVELD addressed Alaskan strengths and weaknesses relative to other countries, states and provinces by listing four categories as follows:

The first set of criteria pertains to the fiscal story, the second set of issues pertains to the potential to raise non-oil revenues, the third is about the outlook for resource production in the jurisdiction, and the fourth set of questions pertain to the management and governance of the entity and structure that manages the SWF asset.

I think based on the size of savings, given what I've just shown you in terms of the size of Alaska's savings relative to the budget, this is a huge positive. On any metric that I can come up with, Alaska is, scaled to its fiscal need, the richest SWF in the world. So that's a huge positive.

What I think is more concerning here is whether the existing infrastructure gives sufficient access to accessible financial buffers. I know you have the infrastructure here, you have funds that are intended to be drawn upon in tough times, I think the concern there is whether those are big enough to help you through a protracted period of time absent some other changes. Where some other countries have provision funds in their stabilization funds or other budget buffer funds that will provide five to ten years of fiscal coverage, here in Alaska it is much shorter. I think something needs to be done in that respect to increase the amount and something can be done in that respect to increase the amount of accessible fiscal buffers at the state's disposal. As I've already mentioned, just purely on fiscal dependence, it's a big negative for me, Alaska does have a much lower recourse to non-oil revenues through taxation, etc.

The fourth thing is the existence of a savings rule here, it is a constitutionally provisioned and 25 percent of mineral royalties is constitutionally required. I know that the historical tradition has been to increase that to 30 percent, effectively that's a huge positive, a lot of countries don't even have that.

[9:50:27 AM](#)

CHAIR STOLTZE asked Mr. Rietveld why he only showed a "one checkmark" approval for Alaska's "existence of saving rule."

MR. RIETVELD answered as follows:

The question for me is whether you shouldn't essentially be saving more, particularly if you are transitioning to a SWF model in which the state's ultimate source of wealth and financing is its financial assets rather than oil wealth, whether there shouldn't be more money and whether that rule should be adjusted to allow for more money to flow into the SWF. I do regard it as a positive that the rule exists, I think there's some scope for improving the rule.

Finally, so that sort of speaks to my second point about the appropriateness of the fiscal rule. In my preamble I was talking about cyclically adjusted

policies, policies that are as good for the upside as they are for the downside. I think that's on the fiscal-rule side where the bulk of the adjustment is required. There is action that needs to be taken that the rule is appropriate as much for tough times as they are for good times.

[9:51:31 AM](#)

MR. RIETVELD addressed long-term and near-term non-oil revenue as follows:

I put question marks around the two issues around the prospects for raising non-oil revenues, both long-term and near-term. I'm leaning towards the negative side on the near-term front, I don't think there's that much you can do to plug the magnitude of the fiscal hole by non-oil revenues, particularly in the short-term. In the long-term I imagine there's potential for it given the very low base, but I'm not sure about it. So I haven't taken a definitive view on it and put them as question marks.

In terms of the long-term viability and profile of all production, I'm simply going here on the model you have all received that the state is working with, the assumption there is of gradual decline in oil production, whereas a lot countries I'm looking at quite the opposite, they are looking at booming production off a very low base. In Alaska it's probably the case that you need to confront the reality of declining production. I didn't make it three-negatives because I do believe they are all prospects, perhaps in a different price environment, perhaps in a different set of circumstances there will be more production coming on stream.

My third set of categories pertains to the management of the funds themselves, in this case the Alaska Permanent Fund. I take it as an absolute strength of your system that the Alaska Permanent Fund is a well-managed entity that it is independent. Through public and political pressures, the Alberta Heritage Fund, which most of you are familiar with, suffered greatly in the 1980s from being used as basically an instrument through which to provide subsidies to invest in uneconomically-unfeasible projects in their province. That's not really under discussion at all in

the case of the Permanent Fund and it's managed by an arms-length, independent authority that has demonstrated clear competence over a long period of time.

Second, I would say that the Permanent Fund's investment style, its asset allocation, what it's investing in, is appropriate and makes sense in terms of what is expected of it; that again, sounds obvious but it's something else that many other funds are struggling with, they have investment income funds and savings funds that are still sitting 70 to 80 percent on bonds because of the inability to diversify the portfolio for a number of reasons. That's not the case in Alaska, you have, I think, a very sensible asset allocation for the fund relative to what you want it to do.

My only concern around the Permanent Fund is particularly pertinent looking forward if Alaska is going to transition towards a state that funds itself through financial income rather than purely oil income is whether there is support for the Permanent Fund to really grasp the nickel of what that implies. If this is the transition that Alaska is making, you need to be able to devote more resources to that organization to do a number of things, most pertinently I think to potentially manage money in-house which economizes on fees paid to third-party asset managers which are quite considerable for the Permanent Fund and it's a logical consequence of the fact that the Permanent Fund currently finds it hard to build up its staff and internal team.

[9:54:47 AM](#)

SENATOR WIELECHOWSKI asked Mr. Rietveld why he gave two-positive checkmarks rather than three to the Permanent Fund's investment style, what risk level should the Permanent Fund take, and how the risk level would impact the rate of return.

MR. RIETVELD answered as follows:

The only reason why I wouldn't give three "ticks" on investment style is it's sort of more an operation issue. With me with the Permanent Fund, the fact that under the appropriate set of circumstances the fund and the corporation could probably economize on fees

to third-party managers, particularly in private markets rather than public markets. So I think if that transition was successfully made, I would give it three "ticks." I think if this transition occurs, that places Alaska in a position of funding itself through financial wealth and financial income. That is where the bulk of the action needs to happen in terms of what the Permanent Fund does and it requires. I have to be very clear about this, it requires political and public support for the Permanent Fund to become truly a world-class, in-house investment manager.

So, SWFs around the world, the large and very successful Canadian public pension funds have no issue around having very significant internal teams, sure it costs you to hire those people, it costs money to build that internal infrastructure, but over the long-run you certainly economize on paying third-party asset manager fees and it also changes the way you do things like real-estate investment. Instead of going to some Wall Street firm and investing in their real-estate fund or creating some kind of real-estate investment platform run by some bulge-bracket investment bank, you are able to initiate the deal flow yourself and find assets that you want to invest in. So it's a mind shift and I think it's one that would serve Alaska very well if you are able to achieve that.

[9:57:06 AM](#)

CHAIR STOLTZE pointed out that the committee intends to bring forward Ms. Angela Rodell, the Alaska Permanent Fund's executive director, to address the committee at a future meeting. He said the committee would address Mr. Rietveld remarks with Ms. Rodell.

SENATOR WIELECHOWSKI recounted that the historical rate of return average for the Permanent Fund was around 6 percent. He asked Mr. Rietveld if he envisioned the investment's level of risk changing in a SWF.

MR. RIETVELD answered that he envisioned the fund's broad and balanced asset allocation strategy to more or less be the same. He remarked that the Permanent Fund was in line with best practices for similar investors such as university endowments and other permanent funds.

SENATOR WIELECHOWSKI asked what rate of return should be expected from Alaska's SWF in order to have a sustainable rate of draw.

MR. RIETVELD answered that the fund's rate of return and draw are directly related to each other. He explained that the fund's return has to be realistic to what the draw is going to be. He specified that a 6.5 to 7.5 percent rate of return would be realistic and appropriate based upon the fund's proposed draw, a rate that had been achieved historically by the Permanent Fund.

9:59:24 AM

CHAIR STOLTZE opined that the administration had been focusing more on the Permanent Fund's harvesting rather than on its sustainability.

SENATOR HUGGINS pointed that the Permanent Fund has been good at operating independently and keeping an eye on Alaskan's investment. He added that the state's other independent corporations should also be recognized as well for acting as a "check." He set forth that the country was based on independence and Alaska would be wise to make sure that independence is celebrated by each of the entities that the state has developed, not only for the Permanent Fund.

10:02:07 AM

MR. RIETVELD addressed the key aspects for a sustainable SWF model as follows:

What I would like to do now is draw down a little bit into the critical elements of if you make this transition to what I call the sustainable, rule-based SWF model. What do you need to do? What is the check list of critical things that need to be achieved? Just to be clear, what I mean by this sustainable, rule-based SWF model in broad strokes is that you're transitioning away from relying on commodity revenues directly, but you are rather transferring it over to a SWF and drawing down on the earnings and financial resources of the SWF.

He explained what the resource-based SWFs are really about as follows:

What are resource-based, commodity-based SWFs really about? I think it all really comes down to a quote by the father of economics, the father of free market

thinking, Adam Smith, who described in his case mining, but he might as well been talking about commodities more generally as "the most disadvantageous lottery in the world," it is a lottery if you are dependent on commodity revenues. Our human ability to forecast commodity prices has time and again been proved to be very limited. Commodity prices act in a completely unpredictable way and putting all of your eggs in that basket is a particularly risky proposition.

So that's really what SWFs in a very big picture is about, it is about removing that degree of uncertainty and dependence on commodities. The first thing they do is they save and in doing so they transform a volatile and depleting asset and income stream into something that can be held into perpetuity, in the case of a permanent fund, and that's a very important point. If you set up the permanent fund in the right way, and I don't think any of the proposals under consideration here would jeopardize that, that financial wealth will outlive oil wealth if you make sure that you are not unsustainably drawing on the fund. Once the last barrel of oil has come out of the ground, you'll still have the Permanent Fund, that's a very significant point to remember.

The second point is that they provided a degree of macroeconomic and fiscal stabilization. The thing here is you are trying to, through the use of the funds and sustainable draws on the fund, decouple the government's spending cycle from the resource-revenue cycle and the resource-price cycle. In Alaska since 1976, essentially, government spending and capital spending has tracked the oil price and oil revenue as it has done in many resource-rich countries prior to the establishment of the SWF model. So you are trying to break that cycle, the decoupling of spending from commodity revenues. You can never get rid of the inherent volatility, it's not like you're going to hide it under someplace where no one is going to see it and it's going to reside in your SWFs. But I believe and proponents of the SWF model believe that that is a better place to place the volatility rather than in the budget. The budget effects all Alaskans, it effects property prices, it effects corporations' planning and investment cycles, and it effects

households' planning and savings cycles. If fiscal policy could contribute towards stability and ameliorating the volatility of the Alaskan economy, that would be a significant achievement.

[10:05:42 AM](#)

SENATOR MCGUIRE asked if there were other funds like the "Alberta model" that addressed volatility by diverting monies when commodity prices hit trigger-prices. She noted that she had proposed trigger-pricing over a decade ago.

MR. RIETVELD answered yes and specified that the funds Senator McGuire described were called the reference-price model. He explained as follows:

You set a price for oil, if oil exceeds that reference-price, you save equivalent percentage of revenues, if it is under that price you are able to draw on it; that is that version of the rule-based policy. That system has some problems, the one is how do you decide which oil price to base it on; that could become incredibly controversial. I think two years ago we probably would have felt comfortable saying the price should be \$100 a barrel, now we see oil prices just touched \$26, we probably don't feel comfortable with \$100. So there is this risk that you would constantly be chasing-your-tail in adjusting the reference-price, unless you have some very sophisticated process for establishing that reference-price, that's my main concern with that model, but it is used and it is employed by some countries.

[10:07:11 AM](#)

He addressed the prevention of waste and bad investments as follows:

Finally, the point of these resource-based SWFs is to avoid really wasteful spending on the boom-side. Economies all have a limited capacity to absorb capital in boom-times, it leads to poor investments and it leads to misallocation of capital to very often unsustainably rising real estate prices, particularly in things that cannot be easily traded tend to really rise. There's a real prevalence of "white elephants," that is large scale investment projects with poor economic performance and rational.

CHAIR STOLTZE asked if a \$65 billion gas line would be considered a "white elephant."

MR. RIETVELD replied no comment. He addressed oil-to-equities as follows:

So just to think through some of the other underling logic of the SWF model, the Norwegians, whose model I wouldn't necessarily advocate in its entirety for Alaska for the simple reason that Alaska is more fiscally dependent on oil than Norway is, but some of the logic applies. The Norwegians describe what they are doing as turning oil-to-equities and they believe that financial assets have historically had a much better risk-adjusted return than oil and also that if you think about it in a truly risk-adjusted sense, the risk of holding oil doesn't compensate you sufficiently for the return that you get and if you think about standard financial theory, the kind of risk you observe from oil would demand much higher returns.

He referenced a graph showing rate of returns since the start of "The Great Depression" in 1928 for stocks, oil, money markets, and bonds as follows:

Stocks have essentially massively outperformed money markets and bonds, but also oil. Oil has exhibited stock-like levels of volatility for bond-like levels of returns. So at least historically, the financial case for turning oil into financial wealth has been very strong, it's even more compelling if you think about the total wealth of Alaska. You have wealth under the ground and you have wealth in financial wealth and if you think about the balance between those two you still will have a significant amount of your current and future wealth in oil, even if you adopt the SWF model. So it's just another reason to, as much as you can, break the consolidation of your wealth in the form of oil wealth and try and grow financial wealth.

[10:09:52 AM](#)

He addressed the reasons to have a rule-based SWF as follows:

I mentioned on a few occasions that the framework should be rule-based and I think that is easily said,

but is worth reflecting for a moment on the attractive feature of a rule. As with all rules in the domain of economic policymaking, the ultimate idea here is to constrain discretion. Why is that important for oil-based economies? In oil-based economies subject to significant booms and busts, I find that memories tend to be quite short and for all of the pain Alaska is going through right now fiscally with low oil prices and economically, when oil prices recover it's very easy to forget that and continue on your merry way. If you have a rule-based policy, that essentially forces you to save in good times, it makes it sort of more reasonable and more sustainable to draw on assets in tough times.

CHAIR STOLTZE asked how rules are enforced.

MR. RIETVELD answered that the state has a number of legal options at its disposal. He stated that the most obvious way was to introduce a law that had significant legislative oversight with public disclosure of what the plan was.

CHAIR STOLTZE pointed out to Attorney General Richards that Mr. Rietveld recommended legislative oversight.

MR. RIETVELD continued to address a rule-based SWF as follows:

I think the second reason for having a rule is the previously mentioned human inability to really forecast where oil prices are going to go. If you have a rule and a framework that doesn't require you to formulate a budget based on your expectation of oil prices, but rather allows you to form a budget based on an assessment of your financial wealth, you are basically expecting a lot less and you are not expecting the impossible from people who write the budget to come up with a forecast of oil prices.

[10:11:57 AM](#)

CHAIR STOLTZE asked Mr. Rietveld to verify that he had previously noted that the most enforceable rule was a constitutional amendment.

MR. RIETVELD answered correct.

SENATOR MCGUIRE recounted the following:

Just on this point to remind the committee, we banded together to pass a piece of legislation that created a competitive oil-review committee that's made up of members of the public and members of the legislature and it's a competitiveness-board based on Alberta's model with an idea that it is our bread-and-butter and we should have more focus on how we manage our competitiveness as a state and it seems like this is a place where that could come in, having somebody, that group, their task is to be looking at how competitive we are with respect to other jurisdictions, but certainly assessing what the price of oil is based on a forecast and things I think would be something.

MR. RIETVELD divulged that the International Forum of Sovereign Wealth Funds codified an encouragement for clear communication and transparency around what the rules are. He set forth what the benefits of rules are as follows:

Helps manage expectations and it helps ensure the credibility of medium and long-range fiscal policy and that's a general truth, but I think it has some specific applications. For example, the rating agencies will have, I think, reason to take significant confidence in a plan that is sustainable, rule-based and clearly communicated; it will help underline the credibility and stability of Alaska's fiscal future if you could communicate a plan like this to the rating agencies; it will help businesses in Alaska break the perception that Alaska is a boom-bust economy and encourage long-term investment in the state; it will help the public's households plan their financial affairs; it will leave their home prices, which is where the majority of their equity and wealth resides, less vulnerable to wild swings based on the whims of energy prices. So I think that's all very important and enhancing the predictability and stability of fiscal policy through this rule-based SWF framework is one of its most attractive features.

[10:14:21 AM](#)

CHAIR STOLTZE remarked that he liked the most enforceable rules. He said a politician he admired, the late Everett Dirksen, said he was "a man of unbending principles" and his first and foremost principle was "flexibility." He asserted that he wanted to make sure that a SWF does not become politically flexible and

noted that the best way to create a \$20 billion permanent fund was to start with a \$50 billion one.

10:15:00 AM

MR. RIETVELD addressed the changing nature of fiscal rules as follows:

I want to pay a little bit of attention now to how rules are changing, so it's not as if there aren't rules in place around the world right now. There is a rule in place in Alaska, a savings rule, but I'd like to talk a little bit about how under this SWF 3.0, this adjusting to new fiscal realities where the action is in terms of the changes that are happening and need to happen. Essentially what I think is in place now in the overwhelming majority of cases is a rule-of-thumb measure for savings, that is how I would describe what Alaska has right now. You have 25 percent required in the constitution that has effectively been 30 percent of savings; let me be clear, having that is better than not having it. The question is can you improve upon it and add a spending component to it, add a sensible policy that integrates your savings decisions with your spending decisions? That's really what it's all about.

In terms of those rule-of-thumb measures, I think there's three in principle. The first one is a fixed percentage savings, that's what you have in Alaska, that's what frankly the majority of countries have. The second one is a deviation from some moving-average so that you save when revenues exceed some moving average of let's say the past four years and maybe you draw down on assets when they are below the moving-average. The third example is the one that Senator McGuire mentioned is the reference-price approach where you set a price in the budget and you say we're going to formulate a budget based on a \$75 per barrel price for oil for example, and if prices end up exceeding that we save that equivalent amount. As I mentioned, these are not terrible rules to have, they are better than not having rules, but they do have problems, particularly with respect to the last one as I mentioned. How do you determine what's the right price? How do you ensure that that process of reference-price setting is not backward looking and if it's going to be forward looking? How do you cope with

inherent unpredictability of oil prices and how do you make sure that the process does not become highly politicized?

[10:17:07 AM](#)

SENATOR MCGUIRE commented as follows:

Just on that point, you're right, but consider that this state has been relying on a spring and fall forecast every year, which is never right, without any trigger at all. So the volatility of what we have is so immense that just ratcheting it back a bit, even if we are slightly wrong on the trigger at least puts us in a place of a bit more predictability.

SENATOR WIELECHOWSKI asked if most SWFs have an inflation-proofing component.

MR. RIETVELD answered that inflation-proofing was a critical element and the best countries did it. He pointed out that Alaska's proposed draw-down rate is below its nominal return and that sort of ensures inflation-proofing because it is through a direct mechanism where money needs to be transferred based on some calculation of what inflation was in previous periods.

SENATOR WIELECHOWSKI asked if the governor's plan had an inflation-proofing component.

MR. RIETVELD answered yes. He detailed that the plan's draw was prudent relative to the expected return of the fund.

CHAIR STOLTZE remarked that one of the rules he did not see was how to avoid getting back into the same spending scenario. He asked if a provision should be included that acts as a de facto spending limit that reduces the amount of money on the table when revenue streams are pretty good.

[10:19:15 AM](#)

MR. RIETVELD replied as follows:

The way I understand the governor's plan is that will happen because the spending rule is based on a fixed amount draw so that if good times return, the fixed amount of spending will remain the fixed amount to spend and the incremental additional revenue will go to the fund. So spending might be able to rise in the future, but it won't respond immediately through the

budget process, it will lead to growth in the Permanent Fund and higher spending for future generations.

CHAIR STOLTZE commented that the Commissioner of Revenue and the Attorney General will be asked to address inflation-proofing and spending rules more in depth. He remarked that the administration has to, most importantly, convince the public.

MR. RIETVELD replied that he agreed. He specified that he was addressing the committee to paint-the-broad-picture, but details were important to review as well. He stated that he could not say that he liked the details of the governor's plan, but remarked that the plan fits with international best practices.

SENATOR WIELECHOWSKI asked if any SWFs existed that spinoff dividends for its citizens and inquired if dividends were a good idea.

MR. RIETVELD addressed the first question and answered no. He specified that the dividend was a particular feature of the Alaskan situation and remarked that he did not take particularly strong views on whether the dividend was a good thing or a bad thing. He commented that the dividend was a liability that the government knows it needs to fund and it needs to think about what the dividend's appropriate level was. He set forth that the SWF was a big-picture plan for enduring the fiscal future for the state to the extent that it helps pay for the dividend in the future. He conceded that dividends might create some opportunities and hindrances in terms of advancing legislation, but dividends should not undermine the transition to the SWF model.

CHAIR STOLTZE pointed out that Mr. Rietveld showed that the Permanent Fund's diversified portfolio was far more reliable than a commodity and the plan switches the dividend payment from the more dependable market-based diversified fund to the vagaries of oil.

[10:22:49 AM](#)

MR. RIETVELD addressed the Saudi Arabian report as follows:

I wanted to discuss it here because I think it underlines the danger of not having a rule-based system in place, it's a very different country to the U.S. and it's a very different set up to the Alaskan set up, I think fortunately in your case, but there

are a number of important lessons that I think we can draw on in doing this. I hope that at the end of these slides, nobody should think that if this proposal is the Saudi Report that I or anyone else is advocating that Alaska does what Saudi Arabia does, it's more the avoidance of the Saudi Arabian Plan.

MR. RIETVELD provided details of the Saudi Arabian report as follows:

The basic economics of Saudi Arabia is that it is the world's largest oil producer, it has sort of been challenged now by Russia and the U.S., but on some metrics it's the largest and certainly one of the largest-oil producers, it has decades if not centuries of remaining oil reserves under the ground, which in general has the lowest-marginal cost of extraction, so their oil wealth is not really in question. At the time we finished writing this report in September 2014, they had \$850 billion in accumulated financial assets, so you might look at those things and say what on earth could be wrong with this country, they have oil beyond their wildest dreams and they have financial wealth; but in fact, there are quite a number of things wrong with the Saudi Arabian economy. The overarching one is that their policies for accumulating and spending assets was entirely ad hoc rather than rule-based, rather than sustainable and rather than appropriately counter-cyclical. In a nutshell, they didn't save enough in the good times and they were drawing too heavily in the bad times.

[10:24:55 AM](#)

He addressed the lessons for Alaska from the Saudi Arabian report and referenced the estimated-oil price required to balance 2015 budgets in various countries as follows:

This is one estimate of the kind of oil price they need to balance the budget [\$106 per barrel], and they are essentially in a different league from the likes of Norway [\$40 per barrel], Abu Dhabi [\$55 per barrel], and Kuwait [\$54 per barrel]; they need roughly twice as high oil price to balance the books compared to those other states who have implemented the SWF model more fully and more appropriately.

MR. RIETVELD pointed out that Saudi Arabia's aging population might require oil prices in excess of \$300 a barrel under its current spending path to balance its books by 2030.

He addressed Saudi Arabia's budgeted versus actual government spending as follows:

Another mistake that they have made is to consistently increase the budget in line with rising oil prices and they have more overspending of the budget in the past decade and a half consistently by roughly 20 percent, which is just directly meaning they are not saving enough money.

He addressed a chart that showed Saudi Arabia's cyclicity in capital spending since 1980. He noted a very close correlation to oil prices and detailed as follows:

We can see they track each other historically. The first thing to give in the Saudi fiscal setup when oil prices collapse is to cut capital spending, that exacerbates the inherent boom-bust cycle of the Saudi economy and I believe has done the same in Alaska and a number of other resource-rich countries and resource-dependent countries, that's certainly not exceptional.

[10:26:44 AM](#)

He addressed a set of investment policies recommended to Saudi Arabia as follows:

Have them manage their wealth institutionally much more like Alaska does, through an independent investment authority with clear expectations in terms of financial returns, people know what targets they have to hit and it's governed in a way that with the particularities of their political setup is essentially arms-length. We call for them to establish a clear demarcation of what is their investment income fund, what is their buffer fund, and we really stress the importance of implementing a rule-based fiscal framework.

He stated that he has three-key takeaway messages for Alaska as follows:

The first message is Alaska is not alone in this response to the oil-price slump; that said, I think Alaska is better placed than almost any place that I have been to with respect to the magnitude of previous savings. You have that very, very significant string in your bow to draw on and that is frankly not the case for many other countries that are going through the kind of pain that Alaska is.

My second and third takeaways pertain to the logic of the SWF model. The SWF model in the first instance is about dealing with the volatility of the budget and it's about transferring that volatility out of the budget, out of spending, out of capital spending and into the level of the SWF, that's very important. The SWF model is a means through which to stabilize the Alaskan budget and to break your historic boom-bust type link to commodity prices.

The third thing I want to leave you with around the SWF model is that it is part of the transition of the Alaskan-state funding itself, no longer as it has in the past through oil revenues, but through its financial wealth and relying on investment income on the wealth rather than revenues from oil production to fund government. I go back to the first point, you're not alone, but you are in a stronger position. You've laid the foundations to make this transition and under the right set of rule-based policies, Alaska has no reason to think that it doesn't have a stable and sustainable fiscal future.

[10:29:34 AM](#)

SENATOR WIELECHOWSKI asked that if dividends are a high priority for Alaskans, wouldn't tying dividends to the stock market be safer than to oil prices. He pointed out that oil prices greatly fluctuate and are projected to continue to decline.

MR. RIETVELD answered yes and pointed out that there are various ways for the state to formulate its dividend policy. He explained the advantage of the governor's proposal as follows:

The advantage of the proposal as I see it is that it allows in good times for the Alaskan citizens to benefit from increased oil revenues, if they are to return, but at the same time allowing the fund to grow, so it sort of is equitable in terms of Alaska's

underlying economic wealth and fortunes tying in part to the Alaskan citizen and in part to the stability of the fiscal framework. So I think the current proposal has the features, I think others are worthy of consideration too.

SENATOR WIELECHOWSKI asked Mr. Rietveld to verify that the proposed plan prioritizes government spending over dividends to Alaskans because the government receives a more stable flow.

MR. RIETVELD answered yes. He specified as follows:

I think the rules sort of balances the benefits of potential higher future-commodity prices to citizens and to the budget. I think there is a tradeoff there, but I think dramatically cutting government spending in the future has an impact on Alaskans' households and individuals too through, for example, their house prices. If you have a 20 to 30 percent drop in your house prices due to a period of protracted low-oil prices; that is a much more significant impact on your household balance-sheet and net wealth.

[10:31:34 AM](#)

CHAIR STOLTZE pointed out the confusion with the plan because the bill is called "The Dividend Protection Act."

SENATOR WIELECHOWSKI asked if Mr. Rietveld would be okay with the plan being flipped where dividends are tied to the stock market and the government expenditures are tied to the price of oil and production.

MR. RIETVELD answered as follows:

I would rather not have government spending tied to the stock market, but I think the SWF model is a way to filter the volatility of the stock market. I do think it's worthy of consideration of other ways of thinking about the dividend. As I said, the way I think about the dividend, and not to get into the details of exactly how it is structured, I think the SWF model, to the extent that it helps ensure fiscal sustainability in the future of Alaska, feeds into the ability to continue paying the dividend, which might otherwise be under threat under whatever circumstances are proposed, particularly the status quo.

[10:32:34 AM](#)

SENATOR HUGGINS asked Mr. Rietveld to verify that Saudi Arabia was bonding their debt.

MR. RIETVELD explained as follows:

What they have essentially done in the first instance is to cut capital spending and the second instance to draw on their accumulated financial assets to the tune of \$150 billion to \$200 billion since December 2014. They have gone to the local bond market and a Saudi-riyal bond of \$37 billion and there's talk of them going to the international bond market to raise a dollar bond. So that's the spectrum of things they are needing to do, all of which are different ways of essentially drawing down on savings that they had previously committed.

SENATOR HUGGINS pointed out that the U.S. has a horrible track record with \$18 trillion in debt and that some people in Alaska have advocated that the state use bonding to take on debt and have somebody pay for it in the future. He asked if the state should consider taking on debt during its transition period.

MR. RIETVELD replied that Alaska has the financial resources not to have to be in a situation where its recourse is to the debt markets and burning future generations. He remarked that the state has the resources in-hand to avoid issuing debt. He pointed out that Alaska's high-credit rating would be under serious threat if the state were to issue debt if the status quo prevailed in the fiscal framework, which would make the debt more costly for future generations.

SENATOR HUGGINS stated that Mr. Rietveld's presentation was meaningful and he was hopeful that the average Alaskan got a lot out of it.

[10:35:11 AM](#)

SENATOR MCGUIRE remarked that a SWF could be created that included dividends being paid out. She said the thinking about attaching a dividend to the royalty itself was to create a revenue-source connection with Alaskans as well as providing an opportunity to experience some highs. She remarked that putting the dividend within a SWF would by definition limit the dividend. She opined that what good was paying dividends if rating agencies said the state was down-the-tubes, businesses relying on ratings were no longer investing and creating new

jobs, the public loses its hope and belief, and housing prices start to go, a scenario that occurred in the 1980s. She asserted that lawmakers were not sitting around finding a way to keep funding government, but were trying to find ways to keep the state economically stable in a way that provides basic services and keeps the economy alive so that the private sector continues to invest.

CHAIR STOLTZE reiterated that the administration focused the discussion on the dividend by calling the bill the "Dividend Protection Act."

SENATOR MCGUIRE opined that the bill was called the "Dividend Protection Act" because the dividend would go away if nothing was done.

CHAIR STOLTZE asked Attorney General Richards to address Mr. Rietveld's presentation, primarily on the deferred questions to the administration relating to inflation-proofing and the dividend.

[10:38:58 AM](#)

ATTORNEY GENERAL RICHARDS explained that the governor's proposal does inflation-proof the assets by defining sustainability and assessing risk for the fund's draw.

CHAIR STOLTZE replied that the committee looked forward to the administration's elaboration on its plan for the fund. He pointed out that the Permanent Fund belonged to the people and not the government. He stated that addressing the governor's bill is an Alaskan debate and the committee would welcome public testimony at a future hearing.

[10:42:10 AM](#)

SENATOR COGHILL commented that Mr. Rietveld's presentation focused on sovereign wealth and the "sovereigns" are the people of Alaska. He asserted that with the way Alaska came into statehood, private individuals' subsurface rights were barred and the state's sovereign wealth is a way to balance and share royalty rights. He said a discussion about sovereign wealth has to include sharing royalty rights with Alaskans.

He remarked that SB 128 is a matter of balancing risk and reward. He said the bill stabilizes the function of income to the government, but the benefit to Alaskans as dividend recipients would be destabilized. He said stabilizing the government's economy is a real benefit, but the dividend

destabilization's impact on the private economy has to be taken into consideration as well.

[10:44:56 AM](#)

CHAIR STOLTZE announced that the committee would spend additional time on the fiscal issues and hold SB 128 in committee until the committee also heard SB 114. He added that public testimony as well as constitutional issues would also be addressed to facilitate a thorough and public-vetting process.

[10:46:56 AM](#)

ATTORNEY GENERAL RICHARDS announced that he and Commissioner Hoffbeck from the Department of Revenue were presenting the bill's framework at the next committee meeting.

CHAIR STOLTZE remarked to Attorney General Richards that probing questions on behalf of committee members' constituents may be asked at the next meeting.

[SB 128 was held in committee.]

[10:47:46 AM](#)

There being no further business to come before the committee, Chair Stoltze adjourned the Senate State Affairs Committee at 10:47 a.m.