

**ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE**

August 30, 2021

10:29 a.m.

MEMBERS PRESENT

Senator Roger Holland, Chair
Senator Mike Shower, Vice Chair (via teleconference)
Senator Shelley Hughes
Senator Robert Myers
Senator Jesse Kiehl

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 53

"An Act relating to use of income of the Alaska permanent fund; relating to the amount of the permanent fund dividend; relating to the duties of the commissioner of revenue; relating to an advisory vote on the permanent fund; providing for an effective date by repealing the effective date of sec. 8, ch. 16, SLA 2018; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 53

SHORT TITLE: PERM FUND; ADVISORY VOTE

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/25/21	(S)	READ THE FIRST TIME - REFERRALS
01/25/21	(S)	STA, JUD, FIN
02/04/21	(S)	STA AT 3:30 PM BUTROVICH 205
02/04/21	(S)	Scheduled but Not Heard
02/09/21	(S)	STA AT 3:30 PM BUTROVICH 205
02/09/21	(S)	Heard & Held
02/09/21	(S)	MINUTE(STA)
02/11/21	(S)	STA AT 3:30 PM BUTROVICH 205
02/11/21	(S)	Scheduled but Not Heard
02/23/21	(S)	STA AT 3:30 PM BUTROVICH 205

02/23/21 (S) Moved SB 53 Out of Committee
02/23/21 (S) MINUTE(STA)
02/24/21 (S) STA RPT 3NR 1AM
02/24/21 (S) NR: SHOWER, HOLLAND, COSTELLO
02/24/21 (S) AM: KAWASAKI
04/21/21 (S) JUD AT 1:30 PM BUTROVICH 205
04/21/21 (S) Heard & Held
04/21/21 (S) MINUTE(JUD)
04/26/21 (S) JUD AT 1:30 PM BUTROVICH 205
04/26/21 (S) Heard & Held
04/26/21 (S) MINUTE(JUD)
04/30/21 (S) JUD AT 1:30 PM BUTROVICH 205
04/30/21 (S) <Bill Hearing Canceled>
08/27/21 (S) JUD AT 1:30 PM BUTROVICH 205
08/27/21 (S) Heard & Held
08/27/21 (S) MINUTE(JUD)
08/30/21 (S) JUD AT 10:00 AM BUTROVICH 205

WITNESS REGISTER

MILAN REITVELD, PhD;
International Sovereign Wealth Fund Advisor
The Center for International Development at
Harvard University Kennedy School
Cambridge, Massachusetts

POSITION STATEMENT: Provided a PowerPoint: Fiscal Rules for Permanent Funds: Global Trends and Practices.

ACTION NARRATIVE

[10:29:27 AM](#)

CHAIR ROGER HOLLAND called the Senate Judiciary Standing Committee meeting to order at 10:29 a.m. Present at the call to order were Senators Hughes, Myers, Kiehl, Shower (via teleconference), and Chair Holland.

SB 53-PERM FUND; ADVISORY VOTE

[10:30:27 AM](#)

CHAIR HOLLAND announced the consideration of SENATE BILL NO. 53 "An Act relating to use of income of the Alaska permanent fund; relating to the amount of the permanent fund dividend; relating to the duties of the commissioner of revenue; relating to an advisory vote on the permanent fund; providing for an effective date by repealing the effective date of sec. 8, ch. 16, SLA 2018; and providing for an effective date."

[SB 53 was previously heard on 4/21/21, 4/26/21, and 8/27/21. Public testimony was open and closed on 4/26/21.

[10:30:30 AM](#)

CHAIR HOLLAND advised the committee would hear a PowerPoint from Malan Rietveld, PhD., an international sovereign wealth fund (SWF) advisor.

[10:31:44 AM](#)

At ease

[10:32:08 AM](#)

CHAIR HOLLAND reconvened the meeting.

[10:33:03 AM](#)

MILAN REITVELD, PhD; International Sovereign Wealth Fund Advisor, The Center for International Development at Harvard University, Kennedy School, Cambridge, Massachusetts, provided introductory comments. He said he previously worked with the Alaska legislature and Governor Walker's administration in 2015 and 2016 on issues related to transitioning to an historic first-time draw on the permanent fund income to support the state's budget.

[10:34:10 AM](#)

DR. RIETVELD began a PowerPoint on Fiscal Rules for Permanent Funds: Global Trends and Practices. He reviewed his credentials outlined on slide 1, including that he worked with a number of governments and the public sector on fiscal reform and sovereign wealth funds (SWFs). He has worked in diverse countries including Botswana and Mongolia and in Alaska and Wyoming. He currently serves as a senior expert consultant to the Asian Development Bank. In addition, he has worked on pension funds.

CHAIR HOLLAND advised that the presentation is posted on BASIS.

[10:35:14 AM](#)

DR. RIETVELD continued to review his background on slide 2. He related that he has also worked at Harvard University and Columbia University producing publications on SWFs.

[10:35:40 AM](#)

DR. RIETVELD reviewed the growth of SWFs on slide 3. He directed attention to the map that identified commodity-based SWFs, which are established to invest a share of the proceeds from natural resources rather than to spend them immediately in a budgetary

process. In recent years, there has been a proliferation of SWFs funded by other forms of public sector revenue and windfall. For example, privatization proceeds in a number of Asian economies, foreign exchange reserves and new funds since the turn of the century. The total aggregate in assets under management by all SWFs in at least 15 countries is \$8-10 trillion. It is difficult to assess the size of the very large Middle Eastern portfolios.

[10:36:56 AM](#)

DR. RIETVELD said the Alaska Permanent Fund Corporation (APFC) is a major player in global SWFs and its investment team is very highly regarded. Other funds seek to learn more about how Alaska's permanent fund was established, its iterations and its investment team's track record.

[10:37:31 AM](#)

DR. RIETVELD emphasized that the current discussions in Alaska are ones he hears in countries throughout the world. He provided three examples of commodity-producing countries with large sovereign wealth funds: Abu Dhabi Investment Authority (ADIA), Kuwait Investment Authority, and Norway. The Abu Dhabi Investment Authority (ADIA) owned by the Emirate of Abu Dhabi has a fund estimated at \$800 billion in assets under management primarily funded by commodity and oil revenues. Currently, ADIA is engaged in multi-year discussion on transitioning towards a spending rule that would allow them to not only rely on oil revenues while saving a significant portion of its revenue but on its earning potential. Abu Dhabi's configuration is somewhat different since it has a number of SWFs, of which the ADIA is the most significant. He characterized ADIA as being on a very similar process as Alaska.

[10:39:05 AM](#)

DR. RIETVELD related that the Kuwait Investment Authority (KIA) is a less positive example. KIA's fund is estimated at \$650-700 billion. In 2020, KIA saw significant draw downs on one of its two funds, its general fund (GF) during COVID-19 which affected its second fund, the future generations fund (FGF). What came to light was that KIA had no formal rule-based framework but relied on custom, consensus and negotiation. That framework has broken down with a standoff between the minister, the legislature and the KIA Board. In the past three months or so there has not been a sitting board, which is just now being resolved. However, it is an example of what can happen absent having appropriate rules in place that are understood by all the stakeholders.

[10:40:19 AM](#)

DR. RIETVELD turned to Norway, which has the largest SWF in the world at \$1.4 trillion. In addition, its SWF provides 75 percent of its revenues from other sources, including sales and income taxes. Although Norway has rarely made draws on its earnings or income from its SWF, in recent years that is starting to shift, he said.

[10:41:14 AM](#)

DR. RIETVELD turned to slide 5. In 2016, Norway made the first historic draw from its SWF. It subsequently made record draws in 2020 and 2021 for relief during the pandemic. Norway forms its budget exclusive of oil revenues, then allows its budget deficit to grow to the estimated earnings of its SWF. Norway conservatively estimates its SWF earnings at 3 percent or approximately \$50 billion in current terms. It then withdraws 3 percent to cover the non-oil deficit. He pointed out that Norway invests more conservatively than the Alaska Permanent Fund (APF). Since this year's draw has been above 3 percent, something must give in the coming years. He said he wouldn't be surprised if Norway formalizes their rules, especially the spending rule.

[10:42:58 AM](#)

SENATOR MYERS asked for the size of the three wealth funds mentioned compared to the size of their economies.

DR. RIETVELD answered that he would need to guess on the first two since Abu Dhabi Investment Authority (ADIA) and Kuwait Investment Authority (KIA) keep their portfolio figures private. But using an estimated \$850 billion for Abu Dubai and \$650 billion for Kuwait and considering pure assets versus the average size of their budget in recent years, most Middle Eastern funds have 3-5 years of budget cover from their SWF assets. He contrasted that Norway has 7-8 times budget cover. He estimated that Alaska would be 10-15 times budget cover from the APF. He pointed out that solely based on the size of the budget versus the size of the sovereign wealth fund (SWF), Alaska has the largest SWF relative to the size of spending. That doesn't speak to the fund's structure or accessing the fund through the spending rule but rather it is a pure "rule of thumb" about the fund.

[10:45:38 AM](#)

DR. RIETVELD turned to a comparison with endowments on slide 6.

[10:46:00 AM](#)

SENATOR HUGHES asked him to repeat the number of budget years the permanent fund could cover.

DR. RIETVELD responded that it would depend on the size of the annual budget, noting that Alaska's budget has increased over time. He acknowledged that Alaska has cut its budget in recent years. He estimated the budget range is 10-15 times budget cover. He added he worked with the Alaska Permanent Fund Corporation Board of Trustees on the publication of a trustee paper in 2020. At that time, a comparison of the size of SWFs relative to spending needs showed Alaska came out favorably. He cautioned against using his exact projection of the number of budget years as a certainty since it is merely an indication.

[10:47:15 AM](#)

CHAIR HOLLAND recalled that he referred to the Alaska Permanent Fund as the largest SWF per capita.

DR. RIETVELD answered that it could be scaled through the size of the gross domestic product (GDP), population or the average spending outlay of government. In all those comparisons, Alaska has a healthy endowment of savings. However, using other metrics, Alaska has vulnerabilities, he said. He highlighted that Alaska has a more certain near-term outlook for commodity production but uncertainty around the timing or magnitude of the state's oil production. Some other funds do not have to draw on the fund and preserve the fund into perpetuity to the extent Alaska does.

[10:48:30 AM](#)

SENATOR HUGHES said the rough comparison is helpful to see how Alaska compares to other SWFs.

[10:49:00 AM](#)

SENATOR SHOWER acknowledged that members who served on the Fiscal Policy Working Group (FPWG) were grappling to find solutions, such as considering using some of funds from the permanent fund to bridge the fiscal gap. He said he was curious if Norway and other countries were using some of their SWFs to help get through the pandemic.

[10:50:00 AM](#)

DR. RIETVELD answered that the overwhelming majority of SWFs are used to provide fiscal support or direct economic support. He opined that the current structure is correct and appropriate for Alaska. One way that SWFs have helped during the pandemic is to shore up private and public financial markets. In Norway, the

last two years have seen the largest draw from their SWF for direct budget support but also the highest POMV draw in the history of its fund. The answer is most certainly yes, he said.

[10:51:28 AM](#)

SENATOR SHOWER remarked that he wanted to highlight that it would not be unusual or unreasonable for Alaska to consider using available funds.

[10:51:52 AM](#)

DR. RIETVELD offered to create a side-by-side analysis of SWFs based on the size of the GDP, budget and population, if requested. He suggested that could be helpful.

[10:52:32 AM](#)

DR. RIETVELD said it was useful to not only compare what is happening with SWFs, but also to consider a close peer, which is university endowments, particularly U.S. university endowments. He directed attention to the chart on slide 6. He said income spending rules vary widely. One major feature is realized income on fixed income and dividends paid on equities. Historically, the majority of endowments have had such spending policies. He directed attention to total investments shown in the first column. Roughly three-fourths of university endowments make use of a POMV approach to spending, which is considered best practice and suitable for the Alaska Permanent Fund (APF). He said he was pleased to see that concept has been adopted since it makes more sense than focusing on realized income.

[10:54:37 AM](#)

SENATOR KIEHL asked for the difference between the "average percentage" and the "Average pre-specified percentage" lines shown on slide 6.

DR. RIETVELD answered that the pre-specified percentage has to do with the timing. He explained the importance of the timeframe being used in POMV calculations. He acknowledged that Alaska has emphasized a five-year lag average, which is more common and by far the best for use with a permanent fund. In universities it is a little trickier because the administration argues that the departments need longer lead times for financial planning due to the leads and lags in university outlays. Thus, universities often pre-specify a POMV based on a historic value, which can be difficult. If the portfolio fluctuates dramatically, it can appear as though there is a massive overspend because the pre-specified amount is being compared to a smaller portfolio.

[10:56:25 AM](#)

SENATOR KIEHL pointed out that the only pre-specified spend amount that exceeded the average percentage funds were the smallest endowments funds under \$25 million. He asked if this was due to their size.

DR. RIETVELD said he thought Senator Kiehl was correct that it is related to smaller schools. He suggested that in typical American universities, the endowment will be a small fraction of their income. He noted that Harvard has the largest university endowment in the world. The endowment income and earnings potential represent a significant contributor to the overall revenue sources of the university in terms of operational purposes. The short answer is that a rule like that is probably a peculiarity of the small endowment which isn't a significant contributor to revenue.

[10:57:54 AM](#)

SENATOR HUGHES recalled he mentioned that using the lag was particularly valuable for Alaska and others are moving to it. She asked if any endowments base their POMV draws on current balance or if these endowments use some type of lag model.

[10:58:18 AM](#)

DR. RIETVELD answered that there are endowment POMV models that work on current value, including Harvard. The POMV calculation is not the motivating factor for determining how much money to draw from the endowment in any given year. Harvard is more focused on a stable spending plan for the university. If other sources of revenue student enrollment fees, gifts, and grants are down in a particular year, the objective of the endowment is to fill the gap. The universities will look back at the POMV size to provide a backward look to provide a sense of spending. Instead of considering the POMV a driving factor, the universities will use it as one of a number of factors to determine whether the university has overspent or underspent. In the event that Harvard has overspent, the university will pull back in subsequent years and likewise, if it has underspent, it will recognize there is room to increase the spending rate. That model has more discretion and it places more of an onus on the corporations that run the university. He said some fairly controversial things happened at Harvard, which he will discuss.

[11:00:00 AM](#)

SENATOR HUGHES asked if during the pandemic these percentages average 4-5 percent or if some SWFs were taking above the amount listed on the chart.

[11:00:14 AM](#)

DR. RIETVELD answered that the survey data he reviewed suggests that spending rates have gone up, but there is variance. In some cases, endowments have pulled back because market losses led to some panic. He pointed out the study cited on slide 6, which was done by the National Association of College and University Business Officers' (NACUBO) Commonfund Study of Endowments (NCSE), which is considered the gold standard for endowment studies. It showed an increase in the average spend rate of 4-5 percent for endowments but the trend is upward in response to COVID-19.

[11:01:21 AM](#)

DR. RIETVELD turned to slide 7 and discussed what happened at Harvard. He said Harvard's endowment consists of over \$40 billion in assets under management so it is the most famous and largest endowment in the world.

DR. RIETVELD said Harvard's spending rule leaves some wiggle room. Harvard's balance of "spending stability" is highly influenced by non-endowment revenue, which fluctuates. The second goal is preservation for the university as a whole as people gift the university.

[11:02:19 AM](#)

DR. RIETVELD highlighted the general target of 5.0-5.5 percent POMV. Although the POMV rate is not binding, it represents the long-term consideration and real earnings potential of the Harvard endowment. He explained that if the long-term earnings are not exceeded, the fund is not drawn down. He noted that Harvard POMV draws have ranged as low as 4.2 percent in 2006 to a pre-COVID high of 6.1 percent in 2010. This year's POMV rate is not yet finalized as Harvard must figure out the value of the portfolio and the size of the draw. He said he could well imagine that the 2021 POMV will exceed 6.2 percent. It will likely be its biggest draw.

DR. RIETVELD highlighted that two things happened in the last two fiscal years. In 2020, Harvard had a highly unusual draw on restricted funds inside the endowment. He noted that 80 percent of Harvard's endowment is earmarked or restricted for specific purposes.

[11:04:11 AM](#)

DR. RIETVELD turned to slide 8. The first bar provides the revenue sources for Harvard for 2020. He pointed out that 37

percent was endowment income or transfers from the endowment. As the other bars show, different parts of the university received bigger shares of the endowment income since some benefactors and donors of the university specify funds for specific purposes or colleges.

[11:05:29 AM](#)

DR. RIETVELD reverted back to slide 7, on Harvard, which read:

- Most famous and largest endowment in the world
- Spending rule leaves some wiggle room
 - Balance of "spending stability" (highly influenced by non-endowment revenue) and endowment growth/preservation
 - "Generally targets" 5.0% to 5.5% POMV - but not binding, and not how the Harvard Corp decides
 - Low of 4.2% in 2006 and pre-Covid high of 6.1% in 2010
- In 2020: highly unusual draw on restricted funds inside the Endowment
- In 2021: growth of dollar value of draw on Endowment originally capped at 1%; but later increased to 2.5% (note: dollar-value spend, not POMV)
- POMV calculation is tricky at Harvard, given timing of financial-planning process and no 5-year averaging
- Harvard has a diversified pool of revenue sources (and access to CARES and PPP funds); with none subject to expectations of structural decline

[11:05:31 AM](#)

DR. RIETVELD said in 2020, the Harvard Corporation, which essentially serves as the legislature for Harvard, agreed to use some of its restricted funds in consultation with donors. This was the first innovation and tweaking of the framework inducted in 2020 to meet the COVID-19 challenges. In 2021, Harvard planned on a smaller POMV draw but later adjusted their figures because the donations and student fees did not recover to the expected level. It then planned to increase the dollar spend from the endowment at 1 percent, but ultimately agreed to increase it to 2.5 percent. Although that is not a jump in POMV from 5 to 7.5 percent POMV, it represents the 2.5 percent growth in the dollar-value drawn. He predicted that this would be a record POMV depending on the timeframe for assessing the size of the portfolio. The portfolio has changed due to market collapse

during COVID-19, but it was experiencing a strong recovery in recent months.

[11:06:45 AM](#)

SENATOR HUGHES referred to the bullet on slide 7, which read:

- POMV calculation is tricky at Harvard, given timing of financial-planning process and no 5-year averaging

SENATOR HUGHES asked if the POMV calculation is done on the current balance.

[11:06:58 AM](#)

DR. RIETVELD responded that the POMV is more of a communication tool than a binding rule. The rule is intended to ensure a stable spending plan without drawing down on the endowment in the long run. Although Harvard reports the POMV in its financial reports, it is done in a backward-looking sense to show in the final analysis, how big was the draw related to the asset size by taking the average value of the endowment over that fiscal year. It's more of a communication tool, he said. For example, if sharp fluctuations occurred in the portfolio, the POMV might need to be applied over a longer period, he said.

[11:07:51 AM](#)

SENATOR HUGHES pointed out that in 2010, the 6.1 percent would reflect the effective rate since it was on the balance sheet. She explained that doing the calculation for the five percent POMV draw in Alaska on 3.069 billion, the effective rate on the current balance would be 3.7 percent. She asked if Harvard's 6.1 percent would be similar to Alaska's 3.7 percent effective rate draw.

[11:08:30 AM](#)

DR. RIETVELD responded that the right way to consider it is as an effective draw. He said he was not entirely sure about whether it is calculated at the end of the fiscal year or if some type of weighted average is done during the fiscal year. He offered to clarify it but reiterated that it is an effective draw based on the most recent fiscal year.

SENATOR HUGHES indicated she would specifically like to know if there is some type of weighted average during the year or if it is done on the end balance.

[11:09:10 AM](#)

SENATOR KIEHL asked if the Harvard Corporation made similarly high draws after its historic high draw.

[11:09:33 AM](#)

DR. RIETVELD replied that what drives the amount of draw on the Harvard endowment is how the other sources of revenue are performing. He explained that if the corporation determined the draw was too high in a particular fiscal year (FY) because other revenue sources were down, it would look for recovery in other revenue sources in subsequent years which would make it possible for them to lower the POMV. He offered to provide the data for the backward-looking POMVs.

[11:10:26 AM](#)

SENATOR KIEHL said the information would be helpful. He also asked if the Harvard Corporation generally is in structural deficit or if revenue and expenditures are balanced annually. Finally, he asked how the decision-makers are appointed or selected.

[11:11:01 AM](#)

DR. RIETVELD replied that the decision-making authority is the Harvard Corporation, which is independent from the Harvard Investment Management Company (HIMC). The Harvard Corporation is an elected body with stakeholders from the donor community, faculty and student representatives. He offered to follow up with particulars on the stakeholder composition. The Chief Financial Officer (CFO) and the Chief Executive Officer (CEO) of the HIMC deliberate on the feasible amount to draw and report it to the Harvard Corporation, which ultimately approves it or requests amendments.

[11:12:07 AM](#)

CHAIR HOLLAND related his understanding that the Harvard Corporation reviews the amount needed based on recent gifts from supporters, then draws from the endowment and the POMV amount drawn is reported after the fact.

DR. RIETVELD answered yes. The best way to describe it is that the POMV is not really the equation being solved. Instead, the Harvard Corporation is solving for spending stability with the constraint that the endowment cannot be depleted in real terms over a two-to-three-year period. The Harvard Corporation uses a backward look to ensure that it is not overspending.

[11:13:53 AM](#)

CHAIR HOLLAND said he didn't want to be misunderstood by saying it was a good method. He recalled earlier remarks that some endowments rely on consensus and negotiation, which is what Alaska has relied on for years. The legislature is currently negotiating a resolution to the impasse. He expressed concern that the PFD payout to Alaskans bounced around from 4-4.5 percent in the first 20 years and it gradually declined such that a \$1,000 PFD is a 1 percent payout of the POMV of the permanent fund. He argued that the PFD should be more than that.

[11:15:12 AM](#)

DR. RIETVELD said he had two final thoughts about Harvard to cover on slide 8. He explained that Harvard Corporation framed its decision to sign off on a 2.5 percent excess draw in 2021 by explicitly citing exceptionally high investment returns it received in the past six months. He commented that the Harvard Corporation's CFO and CEO were comfortable with the decision.

[11:16:07 AM](#)

SENATOR HUGHES recalled he mentioned that the draw from the Harvard endowment fund provides the bulk of the revenue for its operations. She asked if he could provide the percentage in a typical year.

[11:16:39 AM](#)

DR. RIETVELD directed attention to the bar chart on slide 8. In FY 2020, 37 percent of the university's operating budget was derived from its endowment fund. This was a relatively high share given that other contributors were likely down in 2020. He said the projected range would likely be from 25-37 percent. Thus, it is a significant amount but it is not a dominant one.

[11:17:06 AM](#)

DR. RIETVELD related his final point was about Harvard versus Alaska or any country whose economy with a permanent fund funded by commodity revenues. Harvard has volatility and unpredictability in its other sources of income outside of the endowment but it is nowhere near the volatility of revenues from oil and gas, copper or gold. There is no reason to expect that Harvard's donations in 20, 30 to 100 years should decline in real terms. Although it could decrease, it might also increase. Harvard is not confronted with the possibility that one day its source of income will completely dry up and the endowment must provide the revenue source. He viewed it as useful to consider how Harvard contemplates its spending rate and justifies changes to it.

[11:18:14 AM](#)

DR. RIETVELD turned to slide 9, Alaska in Context and discussed how Alaska sits in terms of global SWFs.

- Functions: savings, income and stabilization
- The savings function is firmly established (constitutional certainty); although large share in ERA is a risk
 - The income-producing has come into sharper focus with the POMV
 - However, it currently rests on less solid institutional foundations than savings
- Can be undermined fairly easily
 - The POMV rule also promotes the stabilization function
 - Could be enhanced through a rule to transfer surplus revenues to APF (spending cap; oil price ceiling, etc.). Increases the size of the APF and revenue it generates

[11:18:40 AM](#)

DR. RIETVELD stated that SWFs perform in commodity-based economies in some combination of three functions. One function is to operate as a recipient in savings so future generations can enjoy proceeds from natural resource extraction. The second function is to produce income with one form of asset replacing another asset and one revenue stream replacing another revenue stream. The third function of SWFs provide fiscal and economic stability.

[11:19:21 AM](#)

DR. RIETVELD related that the savings function in the Alaska Permanent Fund occurs with the constitutional provision requiring 25 percent of Alaska's mineral royalties be deposited to the fund, which is somewhat undermined by the structure of the permanent fund. In particular, this is because of the existence of the earnings reserve account (ERA) within the fund and the ease in accessing those funds. In fact, it isn't really a savings account since 25 percent of the fund is available for appropriation by a simple majority vote in the legislature. Even though Alaska has a history of periodically inflation proofing the fund by transferring funds from the ERA, as it stands right now, roughly 25 percent of the fund sits in a structure that is not really a permanent fund in the true sense of the word.

[11:20:33 AM](#)

DR. RIETVELD said what has come into focus since 2014 is the role of the permanent fund as an income source and fiscal stabilizer. On the one hand, the income producing potential of the permanent fund has become well understood and accepted by a majority of the citizens and the legislature through the POMV process. On the other hand, the permanent fund still sits on a less solid institutional foundation since its spending policies lie outside the Alaska Constitution. Since the POMV model and the amount of the POMV draw can easily be changed up or down, it is not ideal for a long-term framework to ensure that one function does not undermine another. Specifically, in Alaska this relates to ensuring that the income-producing function of the SWF does not undermine the savings that has historically occurred.

[11:21:40 AM](#)

DR. RIETVELD directed attention to the bubble chart on the right of slide 9, which provides a visual sense of Alaska's place in the world. The horizontal axis shows that Alaska sits with a group of countries and economies that are highly dependent on commodity revenues, such that 80-90 percent and sometimes upwards of 90 percent of their revenue is derived from oil and gas. This puts Alaska in the company of Middle Eastern economies of United Arab Emirates (UAE), Kuwait, Saudi Arabia, Qatar, and Bahrain. The countries of Bahrain and Saudi Arabia in the green bubble are in trouble if oil prices are below \$80 per barrel. He characterized it as the "break even" price needed to balance the budget. Alaska was in the same position given the size of the budget in recent years. However, with the use of the permanent fund it moves Alaska into the blue bubble. Although the \$50 range shown can't be considered the true "break even" point, it is indicative that is the rate at which the state could likely meet its obligations. That puts Alaska in a group with UAE and Kuwait, he said.

[11:23:24 AM](#)

DR. RIETVELD stated that Norway is less dependent on oil revenues with its budget at 33 percent or lower dependent on oil so it can get by with lower oil prices.

[11:23:43 AM](#)

DR. RIETVELD turned to the role of the permanent fund in providing fiscal stability. The use of the POMV rule, specifically using the five-year moving average provides significant stability to the state's finances. It provides a stable source of income to help avoid fiscal cliffs and crashes. It should help the legislature avoid overspending.

[11:24:14 AM](#)

DR. RIETVELD emphasized that the legislature should consider supplementary measures. If another commodity boom occurred, 75 percent of this revenue automatically is not deposited to the permanent fund. This raises the question of how to allow the majority of the surplus revenue flow to the permanent fund and avoid increasing the budget three-fold during a boom. One option would be to create a spending cap and deposit the remaining of the windfall revenues to the permanent fund or to replenish other fiscal buffers. Another option would be to adopt a rule, which is discussed in the APFC Trustees paper, Volume 9, in which any revenues that exceed \$80 per barrel would be deposited to the permanent fund. Further, on the savings side, the state could have a more dynamic rule and spending caps are one way to get there.

[11:25:43 AM](#)

SENATOR SHOWER commented that Dr. Rietveld highlighted a number of issues the FPWG recommended solving to provide fiscal stability, including the spending cap. He related that a Senate Finance Co-Chair recently stated that the state doesn't have a spending problem but a cash-flow problem so a spending cap is not needed. Several members have been working tirelessly on the FPWG to find a solution. He emphasized that Alaska needs structural certainties moving forward and the state needs constitutional changes to provide certainty.

[11:27:23 AM](#)

SENATOR HUGHES agreed with Senator Shower. She stated that some have proposed that the POMV draw itself is a spending cap but as Dr. Rietveld pointed out, the POMV does not serve as a spending cap during periods of economic booms. However, when there aren't booms, the POMV can function this way, she said. She emphasized the importance of avoiding the fiscal problems that occurred in the 2000s during an uptick in revenue.

[11:28:10 AM](#)

DR. RIETVELD responded that the POMV acts as a spending cap on what might be spent on the permanent fund, but three-fourths of Alaska's windfall revenues will continue go elsewhere unless a mechanism is in place. He suggested placing language in statute or in the Alaska Constitution to state that above a percentage that a significant share of the excess should be deposited to the permanent fund. This would allow the state to increase spending but at a much more gradual rate. In fact, it would help the legislature increase the level of spending permanently but

sustainably rather than moving up and down with the commodity cycle. He pointed out that this is not solely an Alaskan issue but is an ailment that afflicts most commodity-based economies and SWFs. A fiscal rule for the SWF is one way to address that, he said.

[11:29:43 AM](#)

DR. RIETVELD reviewed slide 10, Alaska in Context.

- Alaska has considerable advantages over peers
 - Constitutional clarity and history of savings
 - Very large asset pool
 - World-class investment capacity and asset allocation
- But also weaknesses and vulnerabilities
 - High oil revenue dependence & uncertain long-term production outlook
 - Spending rule lacks constitutional certainty: ERA balances are really exposed (in downturn and a boom)
 - More can be done to save windfalls and break boom-bust link between oil revenues/prices and spending

DR. RIETVELD acknowledged that he just discussed some of the items on this slide but it may be worth repeating. He directed attention to the table on the right-hand side of the slide, which consists of a summary that compares the advantages and weaknesses of Alaska, Wyoming, Norway, Alberta and Saudi Arabia. He reviewed the advantages and the vulnerabilities of Alaska compared to other countries with SWFs.

[11:30:41 AM](#)

DR. RIETVELD highlighted one advantage is the constitutional clarity that Alaska must save 25 percent of its oil royalties in the permanent fund. Further, the legislature has done the right things like inflation proofing the corpus of the fund from the ERA. Many countries with SWFs struggle to adhere to their best intentions to save. He applauded the management team at the APFC for their efforts, including the APFC Board of Trustees' asset allocation.

[11:32:18 AM](#)

DR. RIETVELD elaborated on the weaknesses and vulnerabilities, noting that Wyoming is also dependent but to a lesser magnitude given that a sales tax provides another source of income. Norway

is a large oil producer but it has other sources of income [such as fish, forests, hydropower, and minerals].

[11:33:04 AM](#)

DR. RIETVELD pointed out that Alaska has an uncertain long-term production outlook. He clarified that he was not trying to say it was the end of oil and gas era in Alaska, but the timing of those potentials is uncertain. Further, in the long-term it is difficult to assess the effects of climate change and policies may affect the viability of all producers of fossil fuels.

[11:33:35 AM](#)

DR. RIETVELD related he just discussed the lack of continuity on the spending rule. Although the POMV was adopted in the Alaska statutes in the last few years, the intention to put it into constitutional language is very valuable. He emphasized that the ERA is a legacy of a model framed in terms of realized investment income, related to how the PFD was funded and the old formula. By moving to a POMV model and adopting the mindset that the permanent fund is a permanent source of income to the budget, the ERA is really a piece of legacy architecture that creates not only political risk but also financial risks. The APFC Trustee Paper, Volume 9, also outlined what the state could do if the ERA was depleted through a series of financial market events and ways to ensure that money is available to fund the POMV draw.

[11:34:53 AM](#)

DR. RIETVELD emphasized that rolling the ERA into one SWF portfolio and trying to find a way to finance the POMV is a much more suitable set of arrangements.

[11:35:15 AM](#)

DR. RIETVELD spoke to the last bullet point on slide 10, which encourages the state to save a large portion of any windfalls to raise the level of spending on a more permanent basis and to break the boom-bust cycle between oil revenue prices and spending.

[11:35:49 AM](#)

DR. RIETVELD turned to slide 11, building on reforms.

- APFC Trustee Paper 2020 Vol. 09
 - The Role of Sovereign Wealth Funds in Saving, Stabilization and Generating Income
- Considered what has worked and what has failed in past amongst comparable peers

- SWFs and Permanent Funds in accountable, commodity-based democracies
 - Alberta, Wyoming, New Mexico, Texas, Norway and Chile

[11:35:54 AM](#)

DR. RIETVELD read the first bullet point on slide 11. He pointed out that he keeps coming back to the three points: saving, stabilization, and generating income. The APFC study on the role of SWFs in savings and stabilization considered what worked and failed in the past for comparable peers. The focus was on commodity-based democracies of Alberta, Wyoming, New Mexico, Texas, Norway and Chile.

[11:36:43 AM](#)

DR. RIETVELD turned to slides 12 and 13 listing five key messages.

Slide 12:

- Lesson #1: Mission clarity
 - There has been a shift in the APF's mission: income generation and fiscal stability increasingly important
 - This is now well understood, and should be supported by constitutional language
- Lesson #2: Rules matter
 - Very clear that reliance on custom, discretion and negotiation leads to inferior long-term outcomes
 - Rules de-escalate tough decisions and promote consistency
- Lesson #3: Enforcing rules
 - Alaska (and other US Permanent Funds) have saved because it is Constitutionally mandated
 - Same is rarely true where it is not Constitutionally mandated (many examples: Alberta, Middle Eastern funds, US permanent funds)

[11:37:07 AM](#)

DR. RIETVELD reviewed Lesson 1, mission clarity on slide 12. He noted that there is often no consensus on the purpose of SWFs. Some people think it is there to save while others think it should support the budget in times of crisis. Some think the SWF

is available to invest in the economy and help diversity it. The mission has clarity in Alaska but it has shifted from purely savings to a multitude of functions, including savings, income generation and fiscal stability. He emphasized the need to shore up the Alaska Permanent Fund by adopting constitutional language.

[11:38:30 AM](#)

DR. RIETVELD reviewed Lesson 2 relating to rules. It is difficult to adhere to savings policies during boom times and hard not to draw down on SWFs during tough times. Rules de-escalate tough decisions. Thus, it's a good idea to develop rules for spending the permanent fund in constitutional language.

[11:39:37 AM](#)

DR. RIETVELD reviewed enforcing rules in Lesson 3. He related that the study reviewed permanent funds in the US. Often, the rules relied on statutory provisions, but there were departures from the rules. He acknowledged that Alaska and Wyoming have rules enshrined in their constitutions. He characterized constitutional language as important. He pointed out that Norway has always relied on a consensus model. However, he would not be surprised if Norway does constitutionalize their rules.

[11:40:29 AM](#)

DR. RIETVELD turned to slide 13, building on reforms.

- Lesson #4: Getting a POMV rule right
 - Focus on total returns rather than realized earnings: mindset shift
 - Moving averaging is essential
 - Long-term POMV rate must match long-term portfolio returns, minus inflation and costs
- Lesson #5: Mechanics of the draw and the ERA problem
 - The ERA/principal split creates unnecessary risks: political and financial
 - Having the POMV and the appropriate risk allocation is more important than the Fund's mechanics
 - Trustee Paper 2020-09 considered reform options
 - But no compelling reasons to have the ERA, if one move away from earnings-based spending rule

[11:40:31 AM](#)

DR. RIETVELD explained that the APFC Trustee paper was written during the time Alaska's POMV concept was taking shape. He emphasized that the POMV rule is best practice that is a technical means to formulate a rule for Alaska. It brings a shift in focus from realized earnings to a total return concept. Moving averaging is essential in an economy as volatile as Alaska's economy. Thus, a five-year moving average lag is the best way to smooth some of the volatility in a portfolio that is risk orientated and will have significant fluctuations.

[11:41:29 AM](#)

DR. RIETVELD related that as discussed about Harvard, the POMV provides a sense check about its overall spending. The POMV rate must match the long-term portfolio returns, minus inflation and costs of managing the portfolio. Otherwise, the state risks eating into its portfolio in the long run. Essentially, if a mistake is made by overspending the POMV by .5 percent for a decade, it is much more devastating on a compound basis to the real value of the portfolio than short term overspending followed by a commitment to a more sustainable level of spending. He maintained that the constitutional language is the best way to ensure the POMV rate matches the long-term portfolio returns.

[11:42:49 AM](#)

DR. RIETVELD turned to the bullet point on Lesson 5, related to the concerns about the split between the ERA and the corpus of the fund. He stated that the ERA and principal split does create unnecessary political and financial risks. It results in frequent annual standoffs about how much money to spend from the ERA. In fact, all of the ERA could be appropriated, which would be detrimental to the long-term sustainability of the permanent fund. Further, it creates financial risks. Given a certain set of market circumstances, it would be possible to draw down the ERA to the extent that it would be difficult to fund the POMV on a cash-flow basis. Although the legislature might be reluctant to move funds from the ERA to the corpus of the fund, which would be prudent. It might raise concerns whether there are enough funds to provide coverage. However, it is important that the portfolio is allocated to risk rather than maintaining the ERA.

[11:44:24 AM](#)

DR. RIETVELD said the APFC Trustee Paper, Volume 9, considered a number of ways to retain the ERA by developing a number of supplementary rules like a coverage ratio for the ERA relative to the last two or three years of budget spending. However, if

the option is to roll the ERA into one SWF portfolio, it is much more desirable than trying to retrofit "legacy plumbing" like the ERA, which is not required or suitable to a POMV spending rule.

[11:45:12 AM](#)

SENATOR HUGHES referred to his recommendation to roll the ERA into the corpus of the permanent fund as one means to protect the permanent fund. The state currently requires voter approval for constitutional changes. She related her desire to provide residents with a fair and reasonable dividend. If so, it would encourage voters to approve the constitutional amendment, she said. However, doing so would require an additional 1-1.5 percent draw above the five-percent POMV draw. This would result in a five-percent effective rate draw on the current balance.

[11:46:20 AM](#)

SENATOR HUGHES expressed concerned that if the constitutional amendment fails, it may set a precedent of going above the five-percent POMV. One option could be to place a caveat in statute to reduce the draw to 4-4.5 percent to build up the fund. She highlighted that due to the Alaska Supreme Court decision in *Wielechowski v. State*, the PFD statutes are considered guidelines. She asked if the tradeoff to draw more funds to provide a better dividend is too risky.

[11:47:29 AM](#)

DR. RIETVELD deferred commenting on political judgement. He acknowledged that people are hurting due to the COVID-19 crisis. The additional dividend amount could be considered an economic stimulus so there is an economic logic to it. In addition, there is a need for people to feel they are part of the reform process. The constitutional language for a 50:50 split could be a way to assure people that they are still stakeholders in how the permanent fund performs. The goal is to get the system on a sustainable five-percent POMV. In terms of a course correction in the event the constitutional amendment did fail, the legislature would need to ensure that there was a stronger reaction toward sustainability in subsequent years. He compared it to Harvard's course corrections. The state would need to review its non-permanent revenues and the need to maintain fiscal stability. It means not suddenly withdrawing the amount of activity that government puts into the economy.

[11:49:43 AM](#)

DR. RIETVELD characterized it as a very tricky balancing act. He opined that the policies in the constitutional amendment are sound.

[11:50:13 AM](#)

SENATOR KIEHL asked if his response is why the APFC Trustee Paper, Volume 9, was limited to accountable democracies. He pointed out that the Harvard overseers are elected by the alumni so they are not accountable to the staff and faculty or students paying tuition. It is limited to the donor class. Thus, there is a reasonable likelihood the Harvard Corporation is not going to substantially diminish the endowment, which contrasts with what Senator Hughes aptly described.

[11:51:12 AM](#)

DR. RIETVELD answered that is part of the reason the APFC Trustee Paper did not consider non-democratic authoritarian systems. Another reason is that non-democratic authoritarian systems are not predictable. For example, the Saudi Arabia fund has gone through massive fluctuations. It is not clear to him whether the Saudi Arabia fund is primarily a fiscal stabilization fund, a savings fund or a domestic development bank. One practical point is that the democratic systems have a documented history, which cannot be done in systems that lack transparency. He acknowledged that it is clear that passing good reforms is not easy. Certainly, legislators have thought about ways to garner support for good long-range ideas to constituents, but it is important to find ways to frame the proposed changes for stakeholders. He recalled that the history of the PFD was a means to garner public stakeholders in the process.

[11:53:21 AM](#)

SENATOR KIEHL noted that since the overseers of Harvard have a fiduciary responsibility, they could be sued if they did not get their endowment back on track. However, it is not possible to sue legislators or princes.

[11:53:49 AM](#)

SENATOR SHOWER reiterated that many points Dr. Rietveld made today are in line with what the FPWG came up with, including similar conclusions. The FPWG recognized that multiple solutions were needed. He asked for his insights on the potential for other revenue streams, such as instituting a sales or other tax in addition to the constitutional amendment.

[11:55:56 AM](#)

DR. RIETVELD responded that he did not do a deep look at the numbers but he has some sense. It is clear the permanent fund earnings and POMV alone can't solve the problem, he said. The legislature must develop a comprehensive package that includes new revenues and cuts, not just the earnings. If the permanent fund was \$150 billion, perhaps it could solve the issue, but it is not. He acknowledged that there are many considerations when deciding between a sales tax versus an income tax or a corporate tax. However, he is not an expert on Alaska's overall fiscal situation.

[11:58:13 AM](#)

SENATOR MYERS said the presentation discussed stability, but it appeared to focus on a narrow area of stability for government revenues and hence, government spending. He solicited his comments on how SWFs create stability for the rest of the economy. He expressed concern that the state would be on a path moving forward with a stable government and revenues, with a volatile and anemic economy for the rest of the state.

[11:59:20 AM](#)

DR. RIETVELD stated that there is an innate volatility in the Alaska economy. First, fiscal policy and government spending in Alaska has exacerbated volatility. Thus, spending has risen when revenue has risen due to rising oil prices. It has been cut when oil prices drop, revenues collapse and jobs drop. The initial principal is to do no harm with fiscal policy. The second point is that for lower-income Alaskans, the permanent fund is important to their wellbeing. He emphasized that having a stable and more predictable dividend, which the proposed constitutional amendment would achieve will be helpful. Again, it is like the contribution the permanent fund can make to the fiscal problem. The contribution that the permanent fund can make to the overall volatility is limited but must ensure that the fiscal policy doesn't contribute to the volatility that the Alaskan economy is inherently exposed to. This is quite important, he said.

[12:01:26 PM](#)

CHAIR HOLLAND remarked that no one thought the permanent fund would rise to \$82 billion at this point. He acknowledged that the state borrowed \$14.5 billion from the CBR several years ago that it decided not to repay. Many people would argue that the legislature has not followed the five percent POMV 50:50 plan which could have brought in another \$7 billion. He offered his view that it is important to appropriately address the spending limit. He suggested that this resolution is in the right range.

[12:02:20 PM](#)

DR. RIETVELD noted that the summary on slide 14 was already discussed.

CHAIR HOLLAND asked if there was any value to make a partial repayment to the constitutional budget reserve (CBR) to provide some liquidity, especially if the state does away with the earnings reserve account (ERA).

DR. RIETVELD responded that he would need to consider that aspect. He said he was not sure if it would be better to have funds in the CBR versus the ERA. He related his understanding that it was considered a rainy day fund that was depleted. He said he discussed putting some percentage of any windfalls back into the permanent fund if revenues recover, which is his first option. Another option could be to replenish the CBR and other rainy day funds to avoid an unsustainable draw on the permanent fund in future years. There are merits to replenishing the buffer funds, he said.

[12:02:45 PM](#)

SENATOR HUGHES directed attention to the last bullet point on slide 14, which read:

- Alaska enjoys a number of critical structural advantages
- Big reforms have been made: income- and stabilization functions established
- Time to invest in infrastructure, mechanisms and institutions that ensure this transition - which is permanent - enjoys Constitutional certainty
- The ERA created unnecessary political and financial risks under POMV
 - No compelling reasons to have the ERA, if one move away from earnings-based spending rule
- Ensure unanticipated future revenue windfalls aren't immediately spent, but rather grow the APF or replenish other fiscal buffers
 - For example, spending caps, oil-price trigger, supplementary windfall savings rule
- A bridge period is needed as Alaska transitions to a system with Constitutionally protected savings and spending
 - The bridge should be comprehensive, with all available options on the table
 - One-time higher draws do happen,

- Key is having a credible commitment mechanism to sustainability and rule-based constraint

SENATOR HUGHES related that the committee is working on SB 53, which would make statutory changes to link up with a constitutional amendment. She reviewed the bullet points and said she believes this is what the committee is working towards in SB 53.

[SB 53 was held in committee.]

12:05:19 PM

There being no further business to come before the committee, Chair Holland adjourned the Senate Judiciary Standing Committee meeting at 12:05 p.m.