

The logo for Curtin Business School, featuring the text "CURTIN BUSINESS SCHOOL" in white, uppercase letters on a blue background. To the left of the text is a vertical strip with a dark blue background and a pattern of glowing yellow numbers and symbols, resembling a stock market ticker.

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Government Debt, Spending and the Role of Sovereign Wealth Funds

Curtin Corner

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Curtin University

Sovereign Wealth Funds

- **Reasons to establish SWFs**
- **International examples**
- **Australian examples**
- **Redistribution options**
- **Policy considerations**



Sovereign Wealth Funds

- **Government controlled investment vehicles, often associated with natural resource revenue**
- **Three main reasons to establish resource SWFs**
 - **Intergenerational equity**
 - Finite natural resources
 - **Foreign exchange stabilisation**
 - Offset exchange rate appreciation associated with increased exports
 - **Reducing impact of ‘resource curse / Dutch disease’**
 - Adding discipline to government expenditure



NORWAY'S GOVERNMENT PENSION GLOBAL FUND

Norway's Government Pension Fund Global

- **Established in 1990 as the Petroleum Fund**, and sets aside net cash flow from the extraction of petroleum
- Managed by **Norges Bank Investment Management**
- Despite the change of name in 2006, it is a **general savings instrument**, and is not earmarked for pensions or other specific purposes
- **“Spending rule”** established in 2001:
 - No more than 4% of the fund can be spent on the annual national budget
 - Considering lowering to 3%
- 2016 first net withdrawal – lower commodity prices
- Expenditure increasingly focussed on **education, research, infrastructure and tax cuts**



Norway's Government Pension Fund Global

- **Total value at end of 2016** was 7.51 trillion kroner (**A\$1.16 trillion**)
 - Double the size of GDP
- Invests in: **Shares 62.5%**, fixed income 34.3%, real estate 3.2%
- **Total return: 6.9%** or 447 billion kroner **in 2016** (A\$69b)
- Shares returned 8.7%, real estate 0.8%
- **Annual average return: 5.8%** from 1998 to end Q1 2017
- **After inflation and management costs: 3.9%**
- Management costs of 0.04% of assets under management



Norway's Government Pension Fund Global

- **Share investment has increased as a % of portfolio**, with a target of 60%
 - Potentially increasing this target to 70-75%
- Explicit decisions taken to **sell companies** considered 'unethical'
 - Gradual sales due to size of holdings
- **Does not invest in some industries**, including nuclear weapons and tobacco



TIMOR-LESTE PETROLEUM FUND

Timor-Leste Petroleum Fund

- Following independence in 2002, petroleum and gas exports began in 2004
- IMF recommended establishing a **petroleum fund based on the Norway model** to manage revenues
- **Petroleum Fund Law** passed in **2005**
 - Fund established with US\$370 million
- Operational responsibility lies with the Central Bank
- **Until 2009, invested in US government bonds only**
- Now, revenues are received in central bank account, then **invested offshore by external investment managers as well as the Central Bank**



Timor-Leste Petroleum Fund

- **Balance** of the fund at December **2015 = US\$16.2 billion**
 - GDP 2015 = US\$1.4 billion
- As at December 2015, **assets were invested in:**
 - US government bonds 50%
 - Other government bonds 10%
 - Developed market equities 40%
- **Annual investment return 2005-15 = 3.8% (target 3%)**
- Management fees in 2015 = US\$15.7 million (0.1% of fund)



Timor-Leste Petroleum Fund

- **Transfers** from the fund to government budgets are intended to be limited by the **Estimated Sustainable Income (ESI) – 3% of balance** of fund
- Transfers can be higher than ESI if approved by parliament
 - e.g. 2015 ESI = US\$639 million, actual US\$1.28 billion
- In 2017, 78% of government budget using \$1.1 billion from the fund
- **Declining production and finite resources;** sustainability unlikely
- **Issues** with ESI of 3%
 - **Based on Norway's model** – established nation with lower short-term infrastructure needs (T-L prioritising infrastructure)
 - Conversely, **capacity of the economy** to absorb additional spending is limited, potentially leading to inflation or ineffective / inefficient spending



AUSTRALIAN FUTURE FUND

Australian Future Fund

- **Established in May 2006** to fund the cost of **unfunded defined benefit pension liabilities** for military and Commonwealth public servants
 - Reduces burden on future generations
 - Defined benefits scheme closed in 2006 – by 2040, requirement estimated at \$140 billion
- **Future Fund Management Agency (FFMA)** established to oversee investment
- Commercial funds managers used
- Total management costs in 2015-16 \$246 million
 - Approx 0.2% of funds under management



Australian Future Fund

Asset allocation as at June 2016

Australian equities	6.3%
Global market equities	15.2%
Emerging market equities	7.3%
Private equity	10.4%
Property	7.0%
Infrastructure and timberland	6.7%
Debt securities	11.6%
Alternative assets	13.7%
Cash	21.7%



Australian Future Fund

- **Total value as at June 2016: \$123 billion**
 - **Initial contribution** from Cth Government of **\$60.5 billion** in 2006
 - **Investment earnings of \$62 billion over 10 years**
 - Net return of \$5.6 billion in 2015-16 (4.8%)
 - **Three year average** return of **11.4%**
 - **Target** benchmark of **6.3%** (CPI + 4.5%)
 - **Ten year average** return **7.7%** (Target 6.9%)
- **Four other funds** established: medical research, disabilities, education, building Australia
 - Also managed by FFMA
 - Only last two have withdrawn funds



WESTERN AUSTRALIAN FUTURE FUND

Western Australian Future Fund

- Purpose: set aside and accumulate revenue from the State's finite mineral resources for the benefit of future generations
- Established under the *Western Australian Future Fund Act 2012*, with **seed funding of \$1 billion over 2012-13 to 2015-16** from **Royalties for Regions** fund and interest receipts
- **From 2016-17, additional contributions of 1% of annual royalties revenue**
- Royalties estimated at \$38 million in 2016-17
- Interest estimated at \$35 million in 2016-17
- **Earnings reinvested for 20 years**



Western Australian Future Fund

- **No separate entity created** – transactions managed by WATC on behalf of Department of Treasury
 - Management fee of \$250,000 to WATC in 2015-16
 - Other costs minimal e.g. \$18.50 per WATC bond transaction
- Fund can only be invested in line with the Public Bank Account i.e. **cash and high credit debt instruments**, though the Act also allows for investment in **gold**
- **More than half** the current balance of \$1.1 billion is **invested in WATC and other state government bonds** – as at March 2017:
 - WATC bonds \$199.3 million
 - Other semi-government bonds \$579.2 million



Western Australian Future Fund

- **Average investment return above the cost of funds** in all periods since inception (e.g. 0.4% above cost of funds in 2013-14)
 - Does not allow for impact of inflation
 - Reflects lower risk approach to investments
- Higher yielding investments e.g. **corporate bonds limited to 25%** of portfolio – may be under consideration



Western Australian Future Fund

- **Balance as at June 2032 (current est. \$3.5 billion) to be maintained** – including earnings
- Interest earned on balance of fund from 2032-33 may only be used for **public works and other economic and social infrastructure**
- Any expenditure requires **agreement** between Treasurer and Minister for Regional Development regarding:
 - **Split between metro area and regions; and**
 - **Purpose of expenditure**



ROYALTIES FOR REGIONS

Western Australia - Royalties for Regions

- Established in 2009 to provide an equivalent of 25% of annual mining and petroleum royalties
- Monies are used **over and above normal / planned expenditure**
- Can be used for **infrastructure or service delivery**

- Investment in line with the Public Bank Account
- Any income earned is credited to the fund; however
- **Balance** of the fund **not to exceed \$1 billion**

- WA Regional Development Trust established to provide advice / recommendations to the Minister on how funds are to be spent
- Government approves expenditure as part of the annual Budget process

- Some ongoing expenditure pressures e.g. maintenance and operating costs of capital projects
 - Review flagged as part of 2017 election campaign



OTHER REDISTRIBUTION OPTIONS

Redistribution options

- **Substitute for existing taxes**
 - Personal or business
- **Participatory budgeting**
 - Citizen involvement in expenditure decisions
- Direct **per capita cash payments** to citizens
 - Transparent
 - Equitable
 - Gives expenditure control to the citizens



ALASKA PERMANENT FUND

Alaska Permanent Fund

- Established in 1976 by **constitutional amendment**
- Receives **at least 25% of annual resource royalties**
- Managed by Alaska Permanent Fund Corporation

- Balance as at March 2017 = **US\$57.8 billion**
 - US\$46.1 billion in principal
 - US\$11.7 billion in earnings reserve

- Invests in **income producing** shares, bonds, cash and real estate
 - 8.96% year to date return
 - **7.7% annual return over five years**



Alaska Permanent Fund

- Cash dividend paid to **all residents** of the state (1 yr+)
- Calculated as **52.5% of the fund's earnings** (less expenses), averaged over 5 years / eligible recipients
- Recently approx **\$2,000 per person**
 - 2014 - \$1,884
 - 2015 - \$2,072
 - 2016 - \$1,022 (was \$2,052 – vetoed by Governor)
- Considered income for taxation purposes
- Based on 2015 census data, Alaska had:
 - 4th highest household income; and
 - 5th lowest poverty rate.



POLICY CONSIDERATIONS

Policy considerations

Policy options regarding allocation of resource wealth should consider:

- **Governance and transparency** structures
- Conditions regarding **use of funds**
- **Retention of capital** requirements
- **Risk vs return** of investments and targets
- **Capacity of the economy** to absorb additional funds
- Potential **inflationary impact**
- **Effectiveness and efficiency** of expenditure
- Potential to **involve citizens** in decision-making



DISCUSSION