

Two important revenue management institutions: Sovereign wealth funds and State owned companies

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January 2018

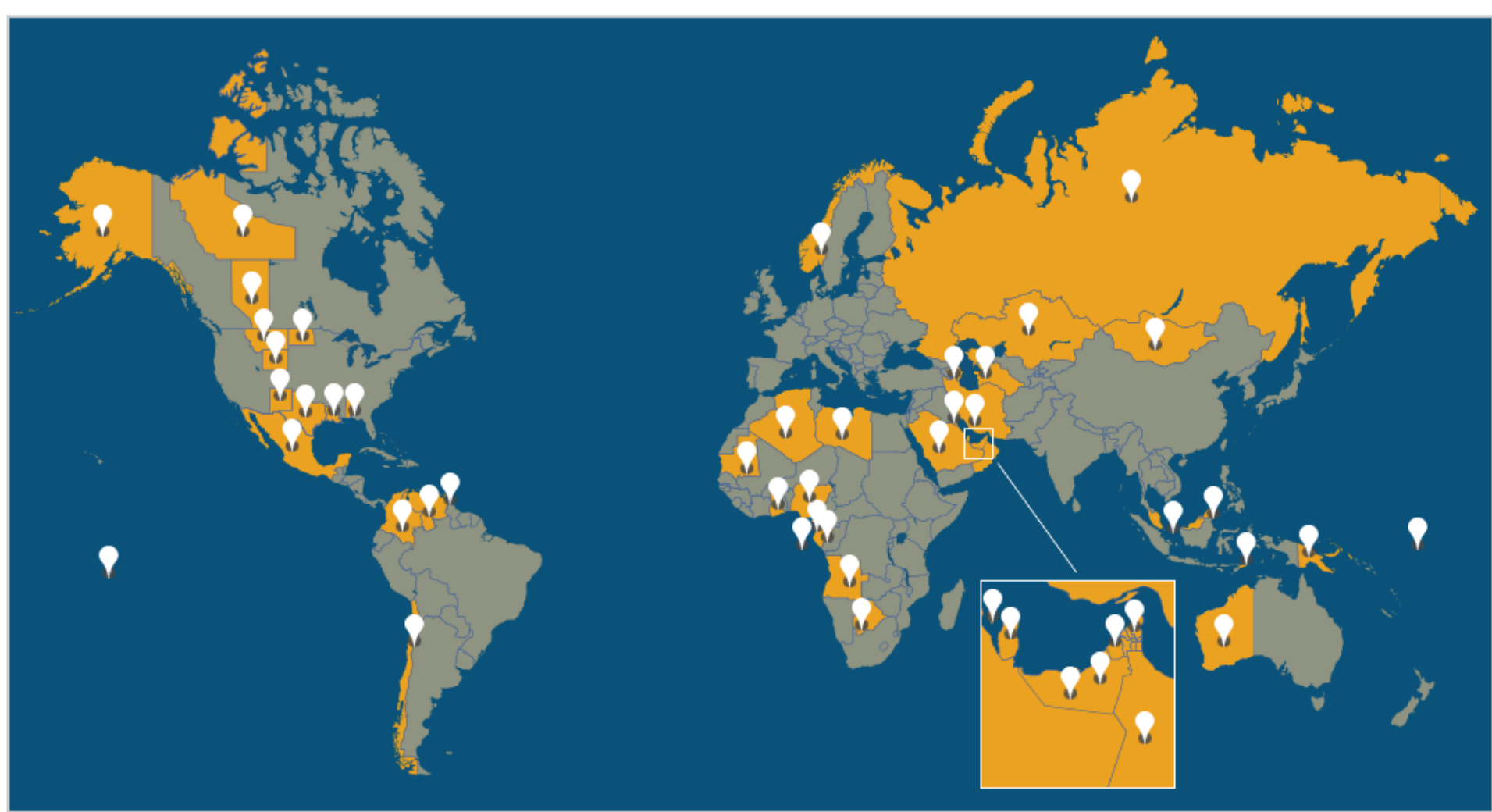
What is a Sovereign Wealth Fund?

**Government-
owned**

**Macroeconomic
objective(s)**

**At least a portion
invested in foreign
assets**

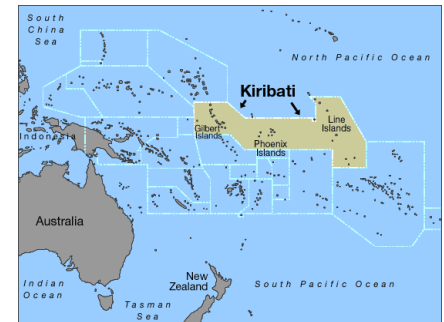
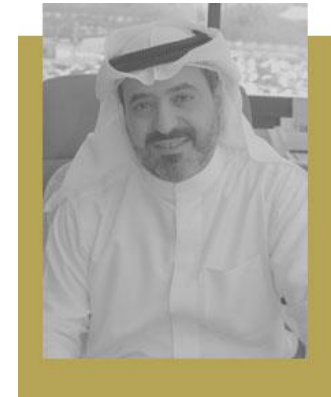
**No liabilities (NOT
a development bank
or central bank
reserves)**



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History of SWFs

- Texas Permanent University Fund (1876)
- Kuwait Investment Authority (1953) – British protectorate
- Kiribati Revenue Equalization Reserve Fund (1956) – British protectorate
- Term coined in 2005
- Approximately 40 new funds since 2000



10 largest (commodity-based) SWFs

Country	Fund name	Date of Creation	Value of assets (2016, latest available or estimate)	Financing resource
1. Norway	Government Pension Fund Global	1990	\$1,002 billion	Petroleum
2. Abu Dhabi (UAE)	Abu Dhabi Investment Authority	1976	\$828 billion	Petroleum
3. Kuwait	Kuwait Investment Authority	1953	\$642 billion	Petroleum
4. Saudi Arabia	SAMA Foreign Holdings	1952	\$514 billion	Petroleum
5. Qatar	Qatar Investment Authority	2005	\$320 billion	Petroleum
6. Dubai (UAE)	Investment Corporation of Dubai	2006	\$210 billion	Petroleum
7. Abu Dhabi (UAE)	Mubadala Investment Company	1976	\$125 billion	Petroleum
8. Abu Dhabi (UAE)	Abu Dhabi Investment Council	1976	\$110 billion	Petroleum
9. Iran	National Development Fund	2011	\$91 billion	Petroleum
10. Russia	National Welfare Fund	2004	\$72 billion	Petroleum

Legitimate SWF objectives

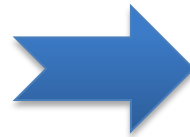
Saving for future generations

Stabilization

Sterilizing capital inflows

Earmarking for specific expenditures

Ring-fencing resource revenues



What matters: clarity, consistent operational rules, adapted to the needs of the economy

Some SWFs are working as designed

- Chile
- Kuwait
- North Dakota (USA)
- Norway
- Peru
- Qatar
- Saudi Arabia
- Wyoming (USA)



جهاز قطر للاستثمار
QATAR INVESTMENT AUTHORITY

Horror Stories



\$1.18 Billion USD



\$5 Billion USD



\$20 Billion USD

Essential Questions

- Why create extra-budgetary funds?
- How should sovereign wealth funds be governed?
- How should natural wealth be managed more generally?

Extra-budgetary institutions

What is an extra-budgetary fund or institution?

Examples:

- State-owned companies
- Pension funds
- Sovereign wealth funds
- Multi-year investment funds
- Earmarked special funds
- ‘Slush funds’

Why create an extra-budgetary fund?

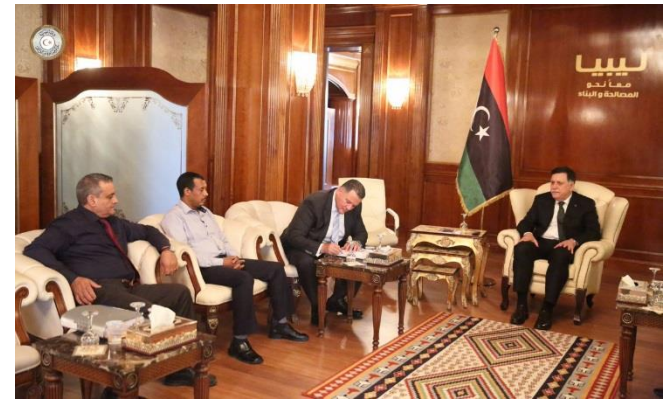
- Manage saved fiscal surpluses or stabilize the budget
- Secure source of funding for underfunded expenditure items
- Depoliticize certain allocations and prevent budget cuts (e.g., pensions)
- Circumvent poorly functioning budget institutions
- **Avoid public scrutiny and PFM systems**

Off-budget vs. on-budget

Does money flow through the budget process? Or do spending decisions bypass the budget?

Examples of other resource-financed extra-budgetary funds

- **Strategic investment funds / development banks**
 - LLIDF (Libya)
 - Bahrain's Mumtalakat
 - Russian Direct Investment Fund



Mumtalakat
INVESTING FOR BAHRAIN

Examples of other resource-financed extra-budgetary funds

- **Earmarking funds**

- Timor-Leste's Infrastructure and Human Capacity Development Funds
- Alabama Capital Improvement Trust Fund
- *Fondo de Ecodesarrollo* (Ecuador)

- **Community development funds**

- Raglan Trust (Canada)
- Regional Development Funds (Kyrgyzstan)
- Niger Delta Development Commission (Nigeria)



Good Governance of SWF

1. Set clear fund objectives
2. Establish fiscal rules
3. Establish investment rules
4. Clarify good institutional structure
5. Require extensive disclosure and audit
6. Establish strong independent oversight

Rules

Deposit Rules



Sovereign Wealth Fund



Withdrawal Rules



Domestic Expenditure

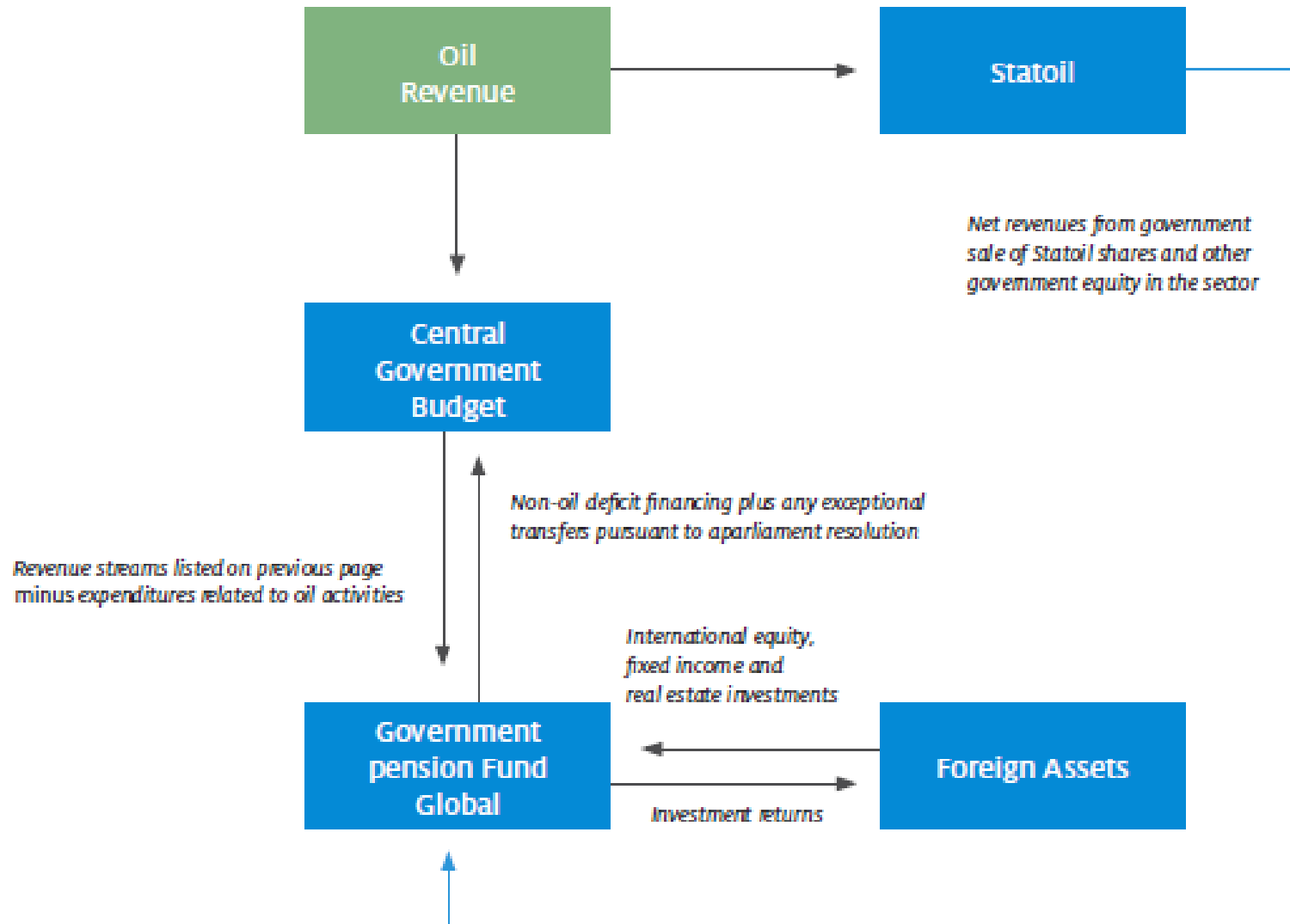


Investment Rules

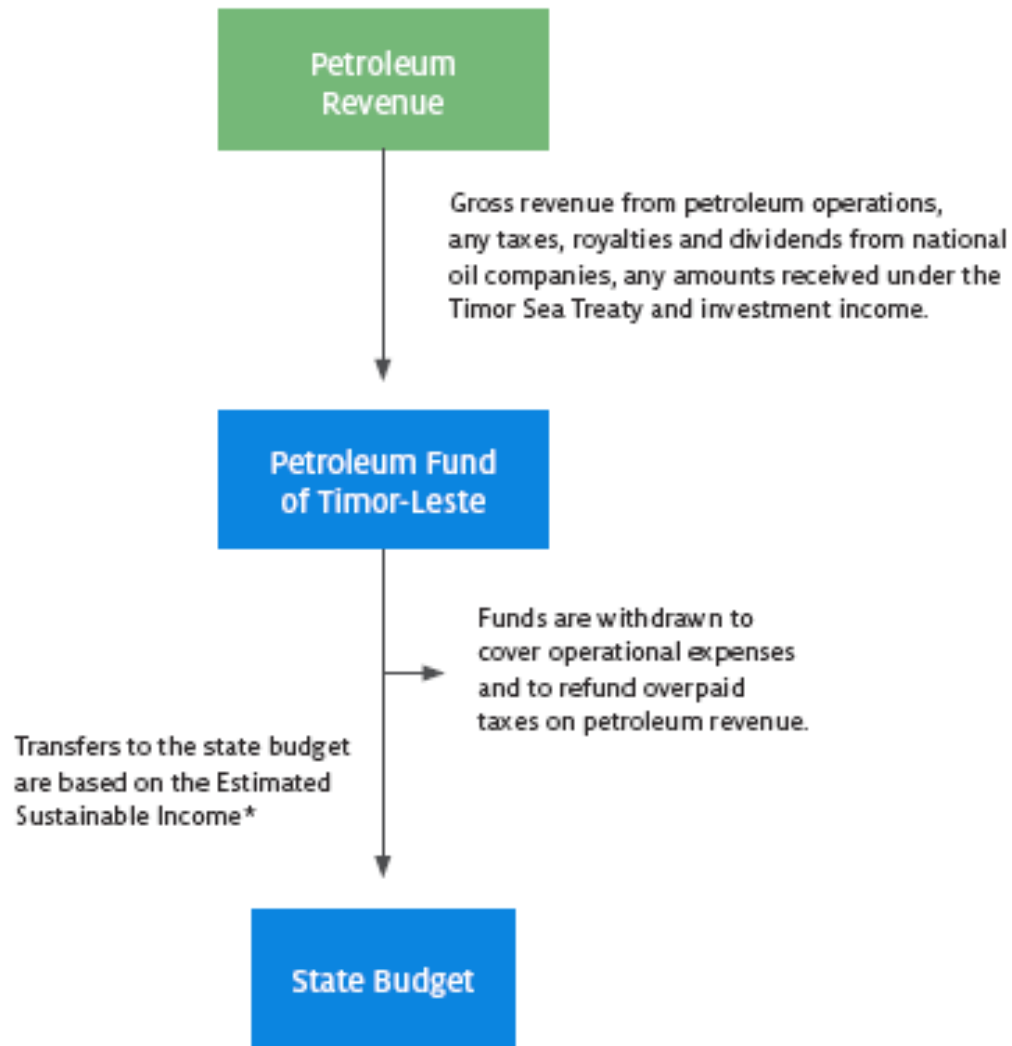


Foreign investment

Norwegian System

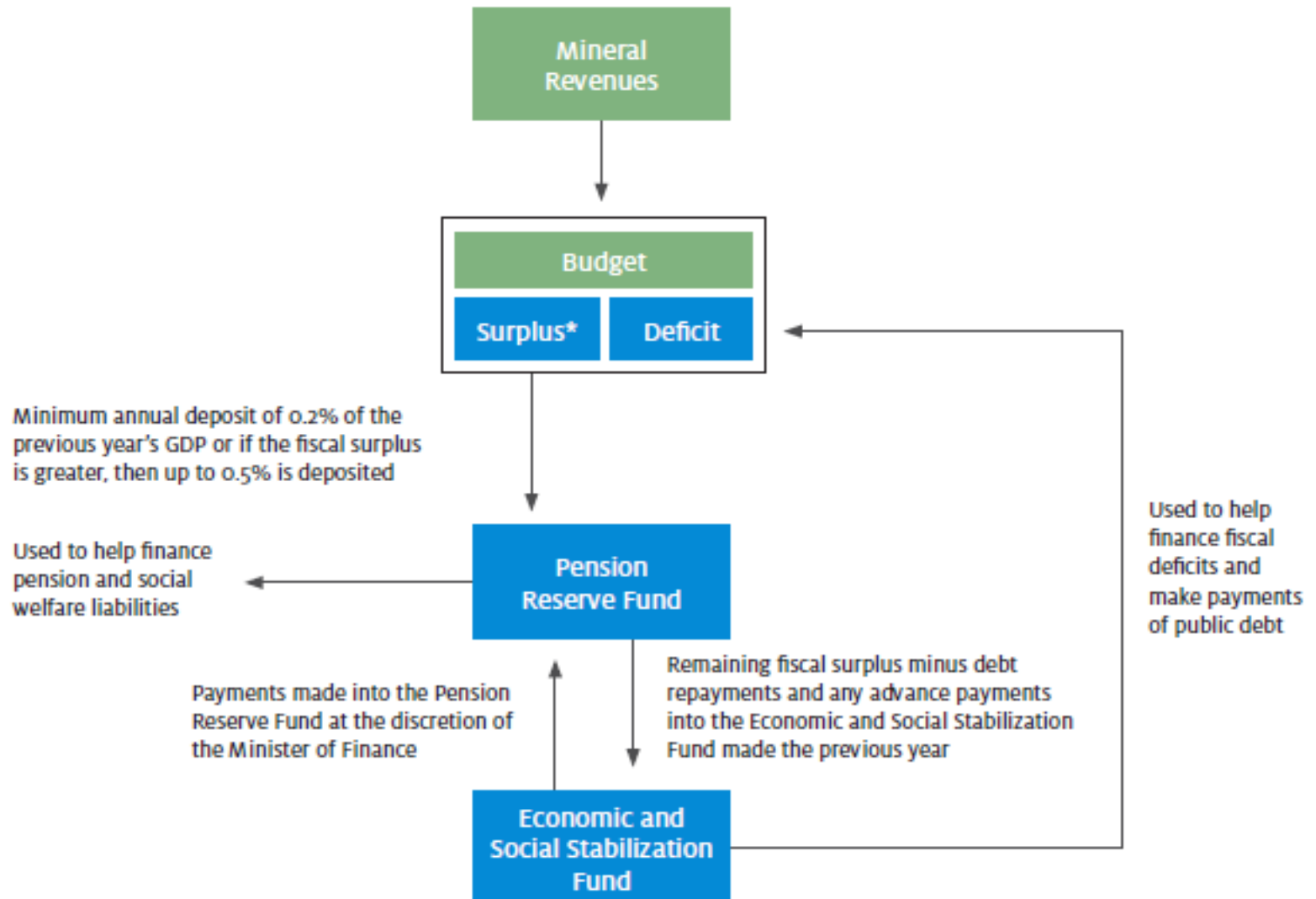


Timor-Leste



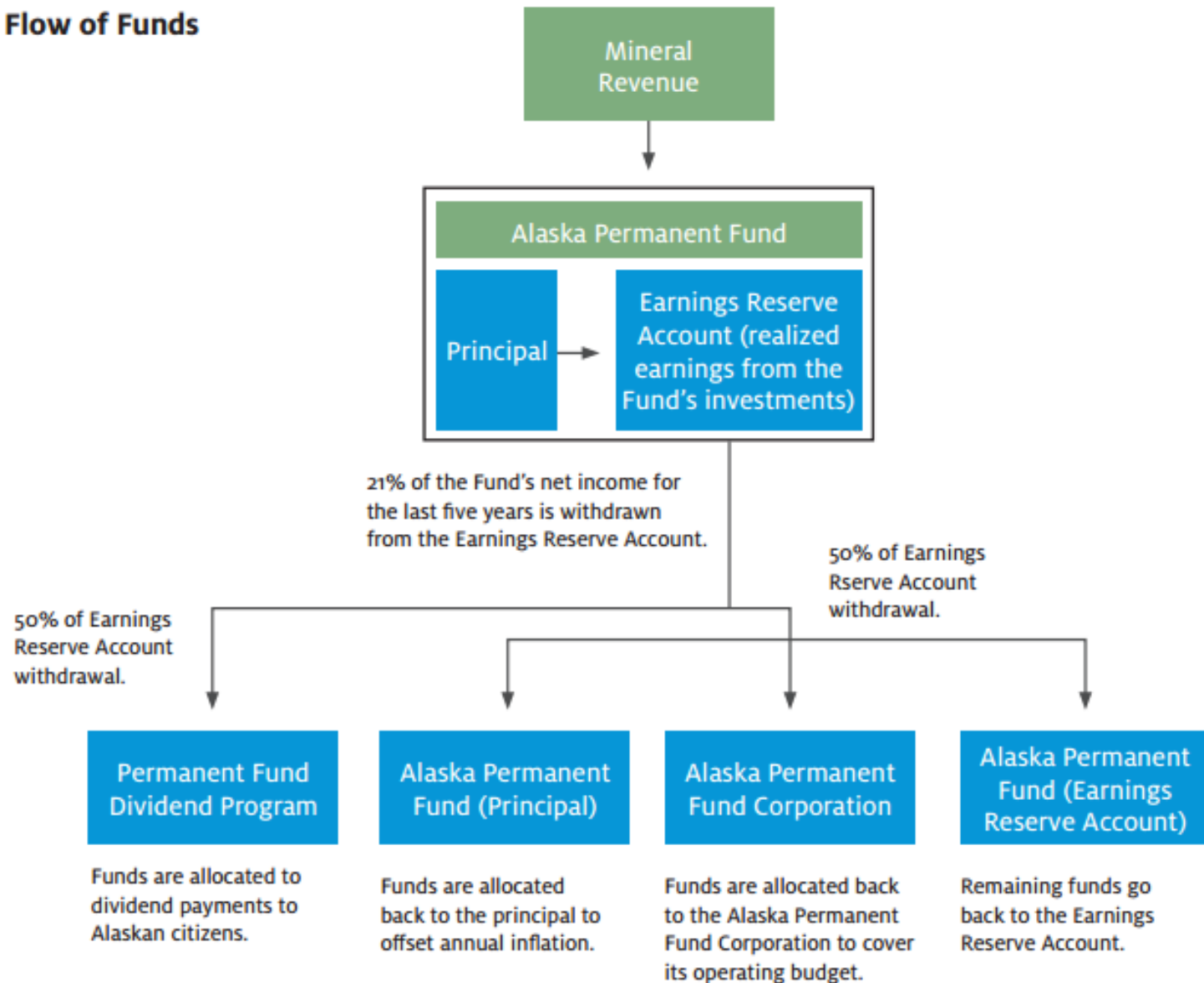
*Currently defined as 3 percent of the value of Timor-Leste's petroleum wealth.

Chilean System



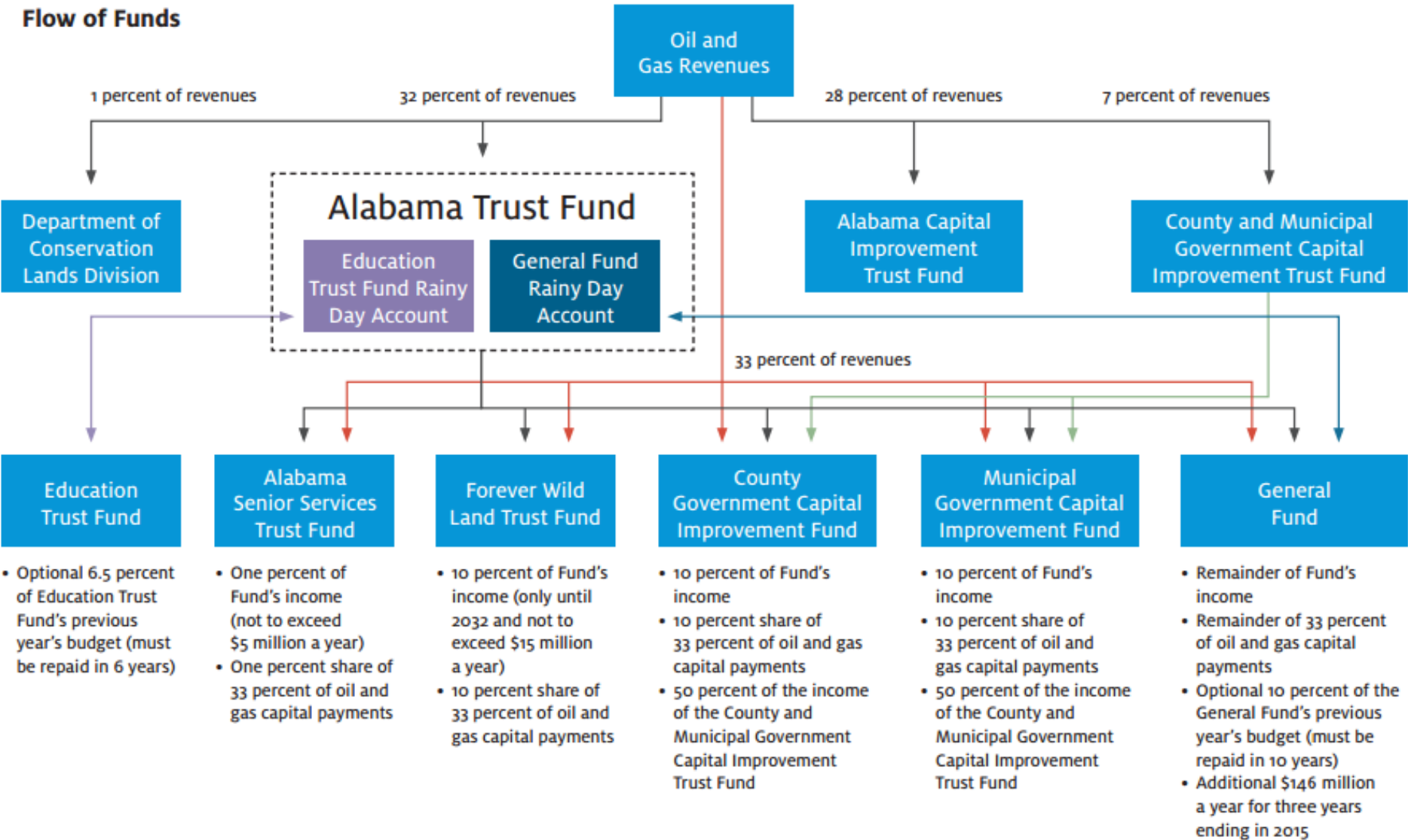
Alaska (USA) System

Flow of Funds



Alabama (USA) System

Flow of Funds



Earmarking

1. Fund objectives
2. Fiscal rules
3. Investment rules
4. Institutional structure
5. Disclosure and audit
6. Independent oversight

- What are the advantages and disadvantages of earmarking?

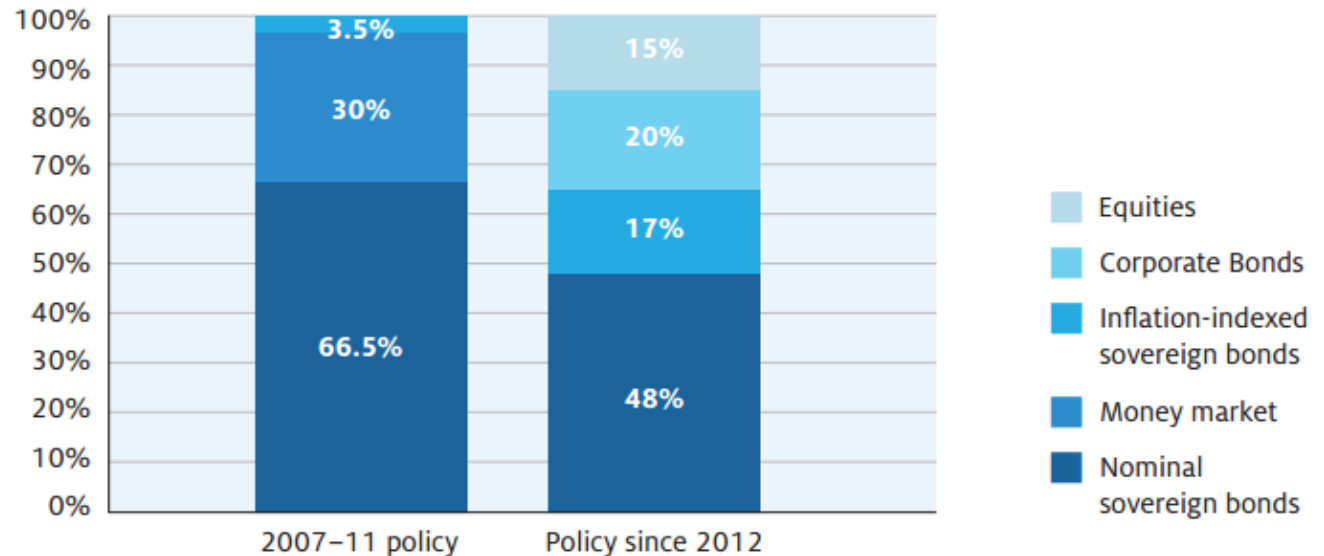
Questions

1. Fund objectives
2. Fiscal rules
3. **Investment rules**
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- What are the options for investment?
- What factors should a government consider when investing?
- What options are at the government's disposal to ensure investments match their goals?

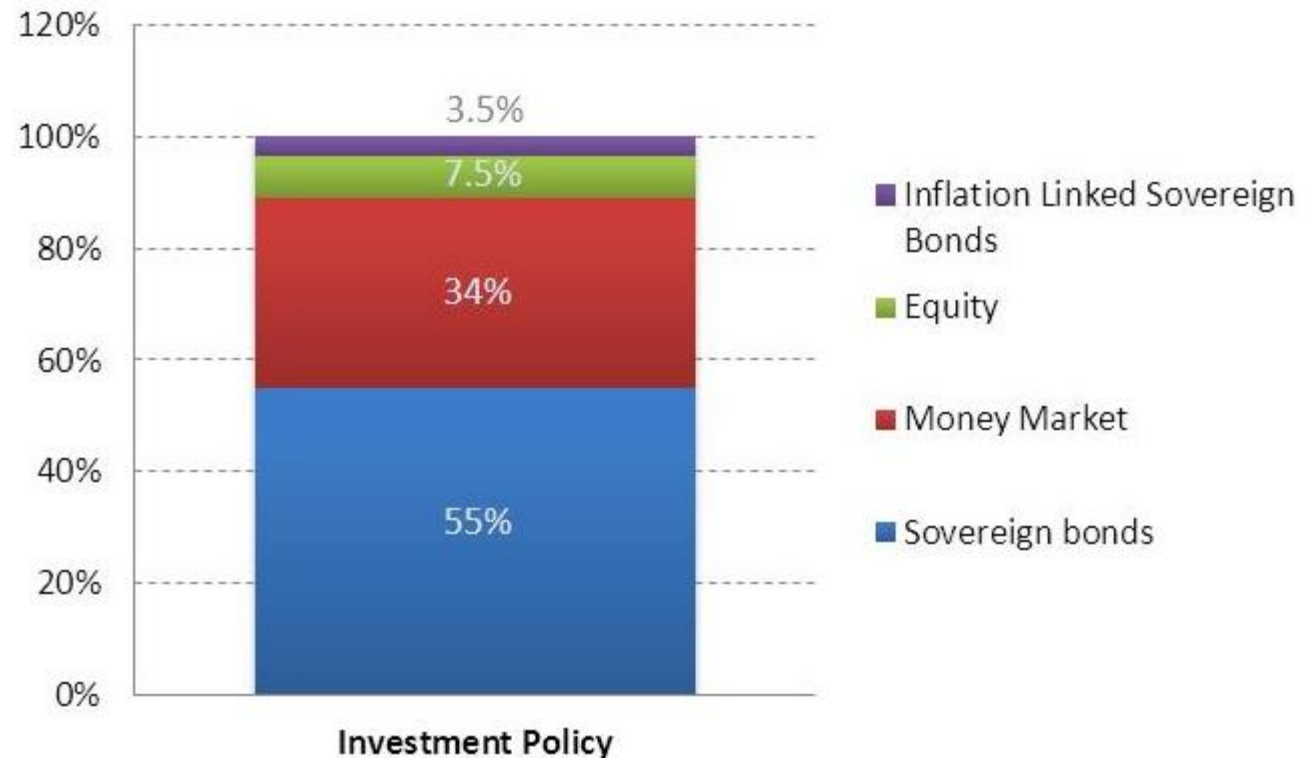
Chile Pension Fund

1. Fund objectives
2. Fiscal rules
3. Investment rules
4. Institutional structure
5. Disclosure and audit
6. Independent oversight



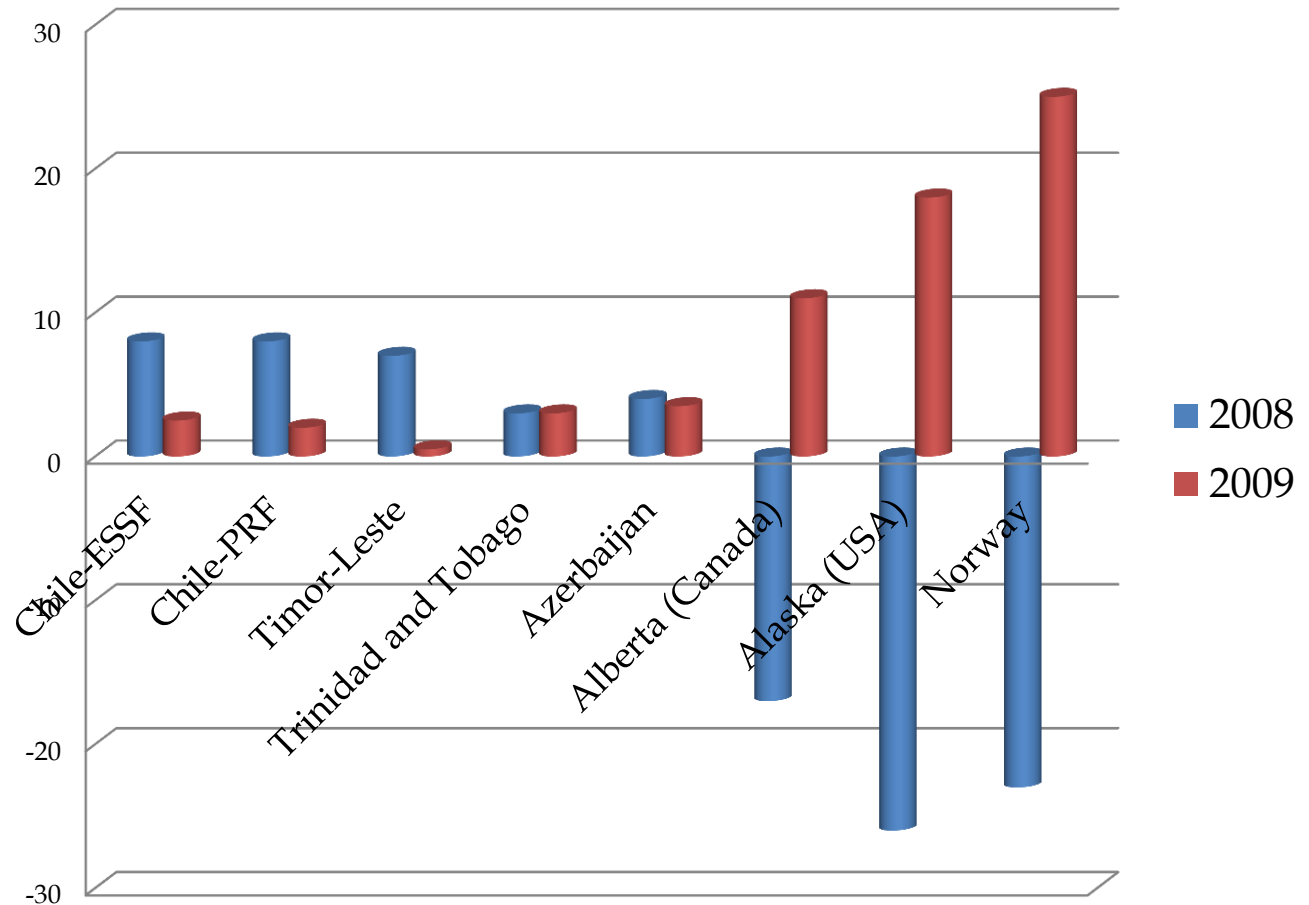
Chile Stabilization Fund

1. Fund objectives
2. Fiscal rules
3. **Investment rules**
4. Institutional structure
5. Disclosure and audit
6. Independent oversight



SWF returns (percent) during the global financial crisis

1. Fund objectives
2. Fiscal rules
3. Investment rules
4. Institutional structure
5. Disclosure and audit
6. Independent oversight



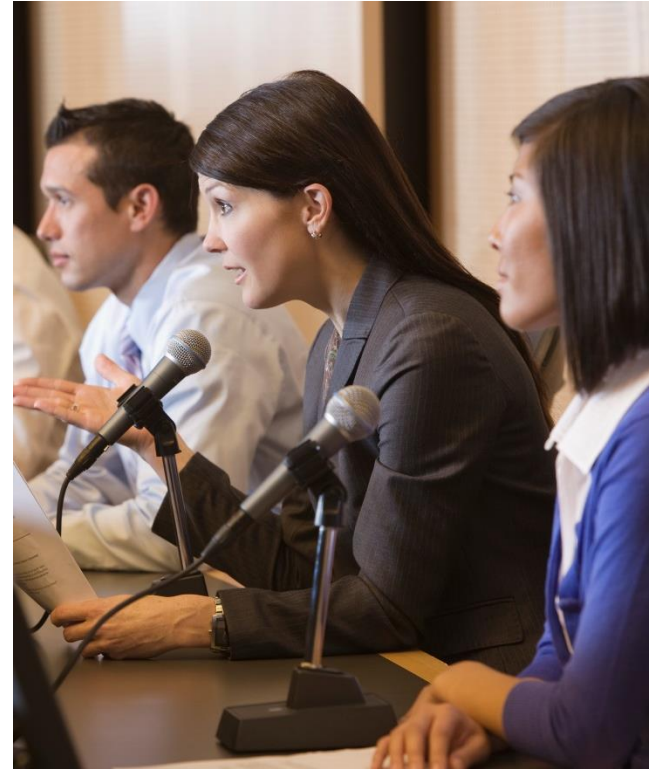
Questions

1. Fund objectives
2. Fiscal rules
3. **Investment rules**
4. Institutional structure
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6. Independent oversight

- Should a SWF be allowed to invest inside its country or state?

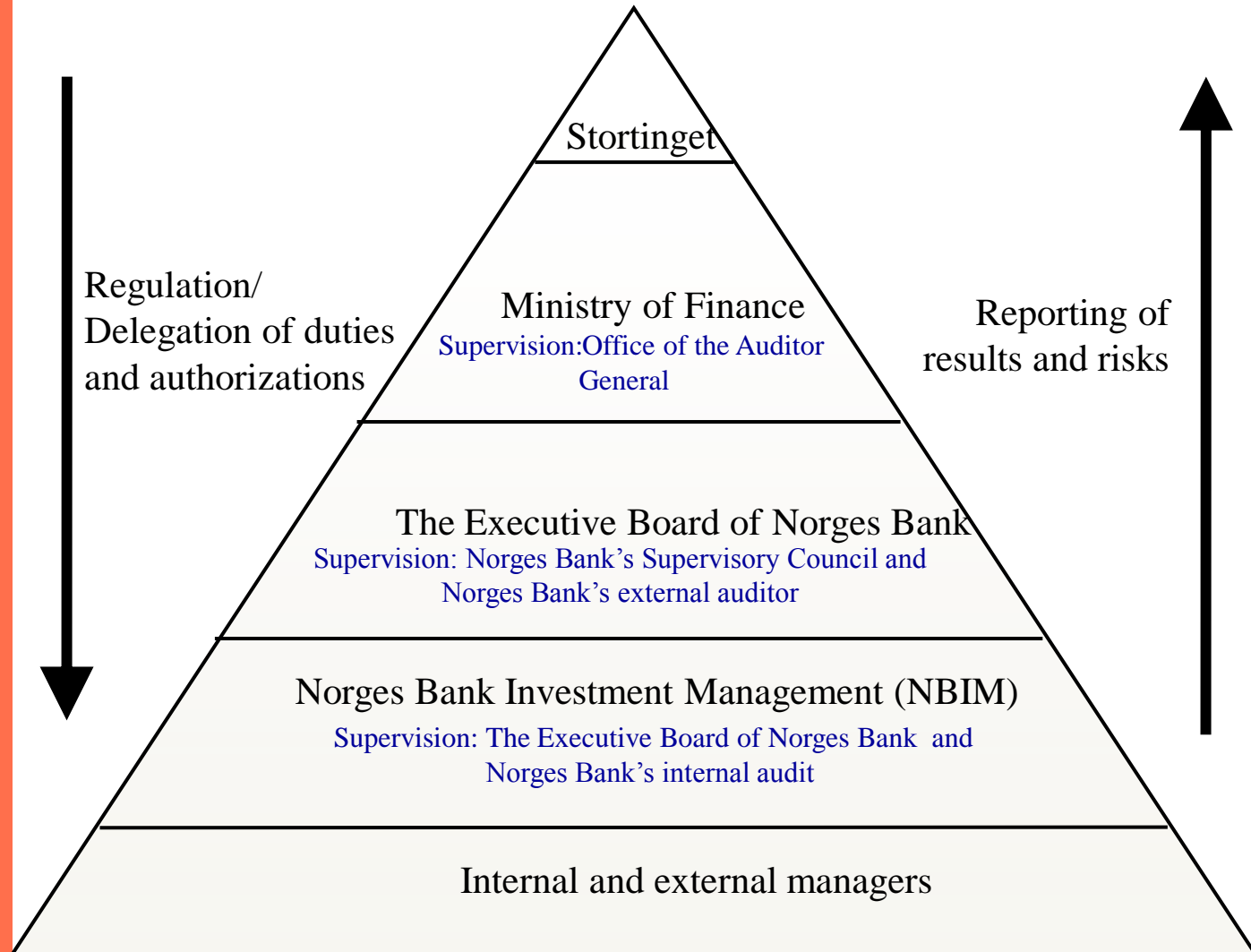
What mechanisms promote compliance?

- Robust organizational structure
 - Economic development ministry or agency
 - Compliance or audit within the bureaucracy
- External oversight
- Consensus building



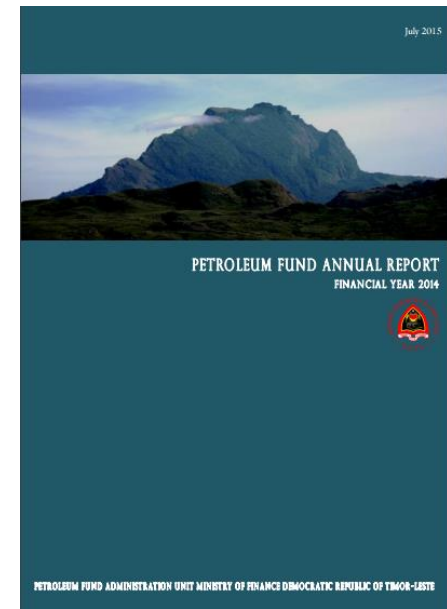
Norway

1. Fund objectives
2. Fiscal rules
3. Investment rules
4. Institutional structure
5. Disclosure and audit
6. Independent oversight



Require extensive disclosure and audit

1. Fund objectives
2. Fiscal rules
3. Investment rules
4. Institutional structure
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6. Independent oversight



Examples of independent external oversight

1. Fund objectives
2. Fiscal rules
3. Investment rules
4. Institutional structure
5. Disclosure and audit
6. Independent oversight

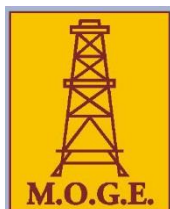


- Meetings with parliament
- Judiciary
- External auditor
- Auditor-General
- Media
- CSOs
- International institutions

Good Governance of SWFs

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State-owned enterprises (SOEs)



PETRONAS



КазМұнайГаз
NATIONAL COMPANY УЛТТЫК КОМПАНИЯСЫ



ارامكو السعودية
Saudi Aramco



Does a state owned oil or mining company better allow the government to promote and control economic development, redistribute income and promote the national interest?

Or does it divert revenues away from health, education and infrastructure investments?



Statoil

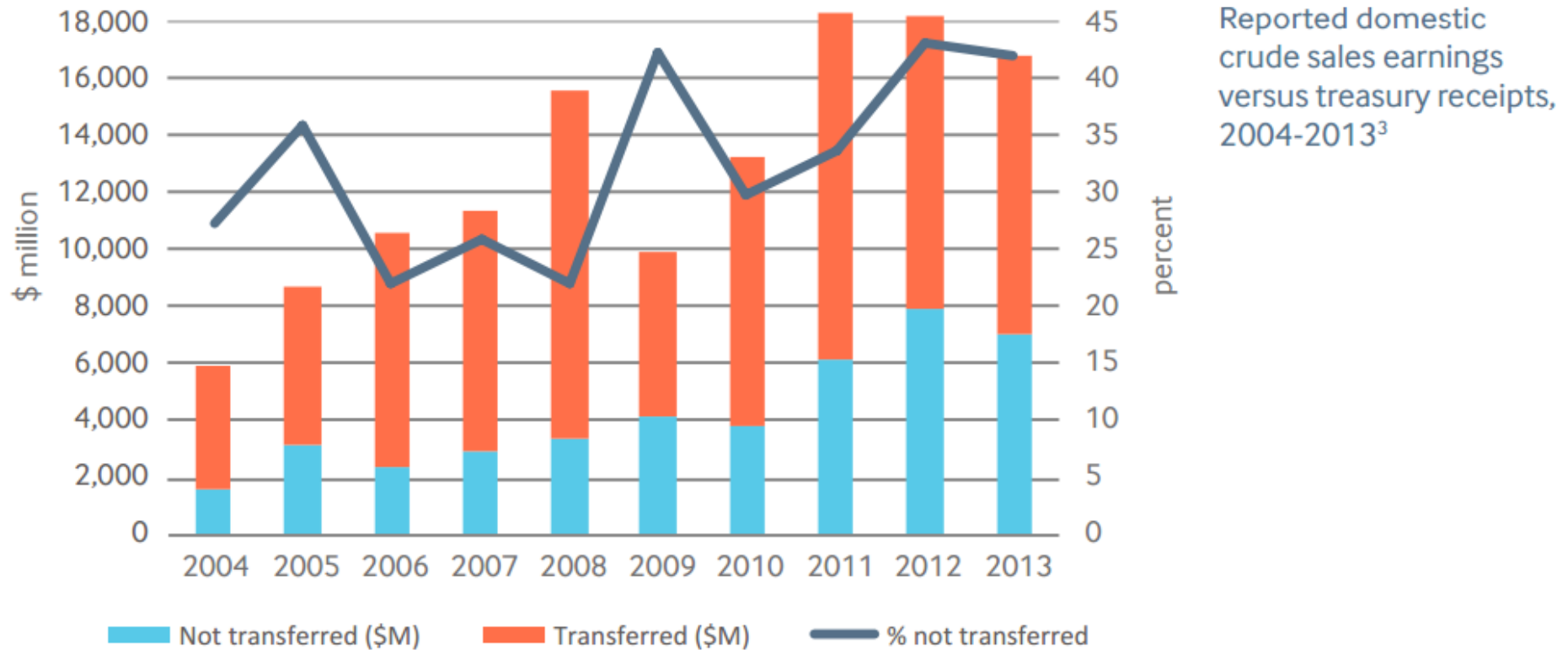


PERTAMINA



Example 1: Nigeria

a) Domestic Crude Allocation



Example 1: Nigeria

b) Revenue retention by subsidiaries

- Five offshore oil trading subsidiaries (held in Panama, UK, Bermuda and Nigeria) – earnings are unknown
- The Nigerian Petroleum Development Company, NNPC's upstream arm, retained USD 6.82 billion in 19 months from 2012-13 without major operating costs; no justification or explanation how the money is spent

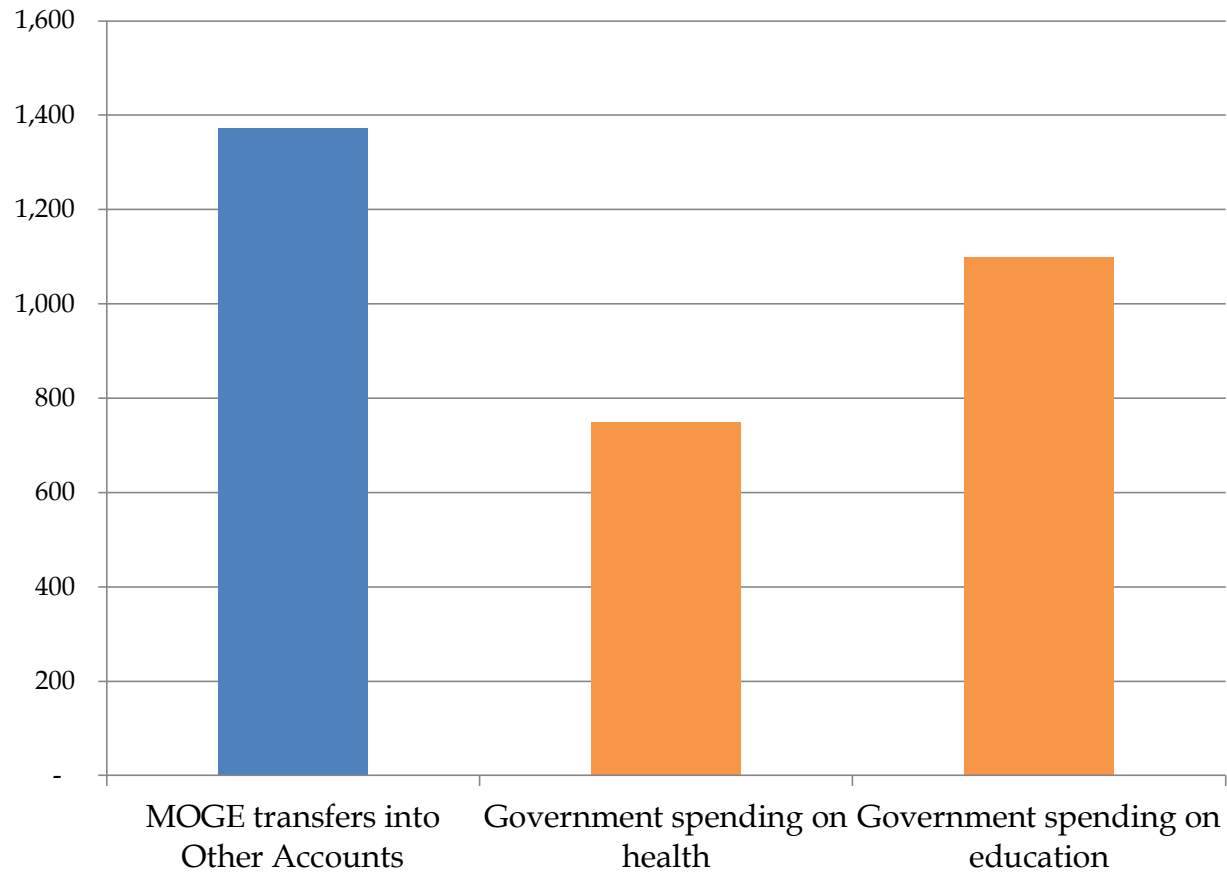
Example 1: Nigeria

c) Oil-for-product swaps

- 1/10th of crude oil (USD 35 billion from 2010-14) sold for diesel, kerosene, gasoline and other final products
- A single bad contract – for example allowing swaps of oil for less valuable products – cost NNPC at least USD 381 million in 2011
- Little verification of compliance with contracts

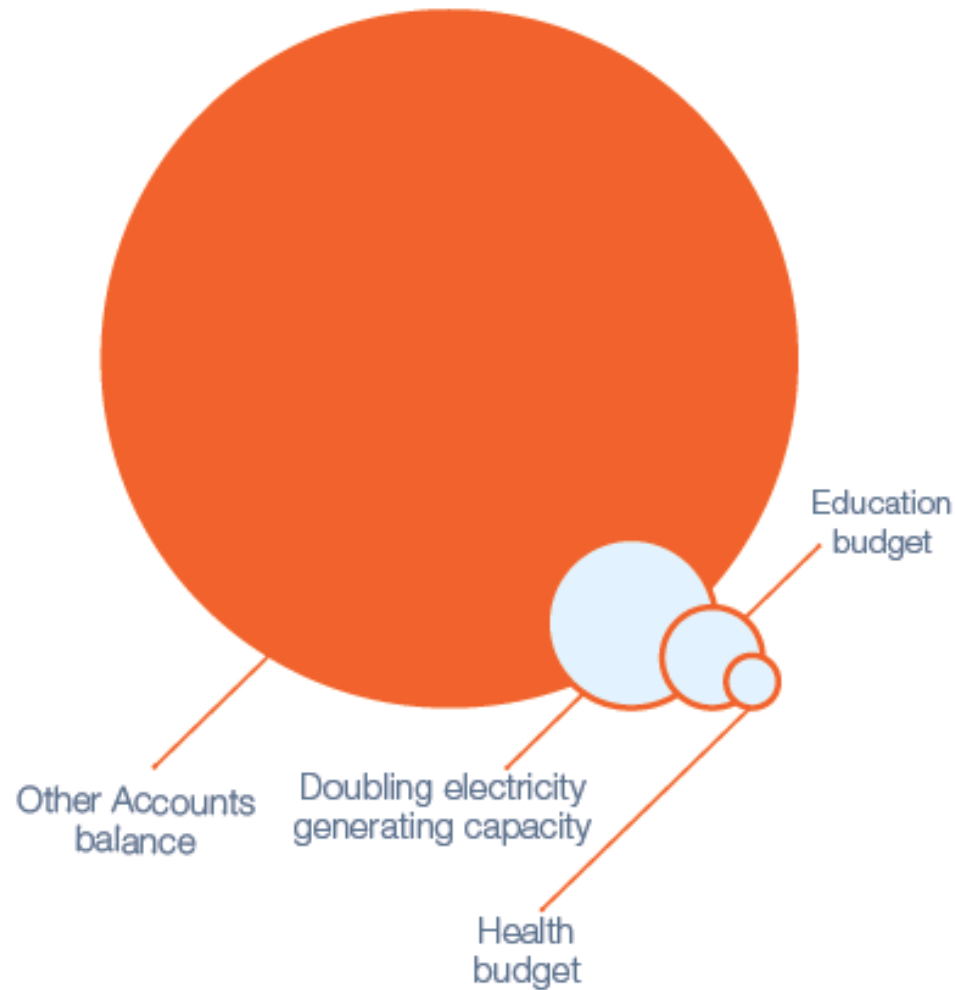
Example 2: Myanmar

Revenue retention



Sources: EITI, IMF

Myanmar SOE 'Other Account' balances



Key issues in SOE governance

1. Scope of SOE activities
2. Benefits of SOE participation
3. Risks of SOE participation
4. What works? SOE accountability mechanisms

NOC/NMC mandates

Commercial

- Sell government share of crude oil or minerals
- Manage state equity participation

Operational

- Participate in exploration and production activities

Regulatory

- Negotiate petroleum/mining licenses
- Regulate the sector
- Monitor compliance to regulations

Development

- Capacity building in the industry
- Local content promotion
- Corporate social responsibility initiatives

Benefits and risks of NOC participation

What are some major benefits that a country can gain by creating a major role for the NOC?

- Development of national skills
- Long-term economic control and financial returns
- More effective state control over the pace and development of the industry
- Stimulator of local content and positive economic spillovers



What are some major risks associated with a large role for an SOE?

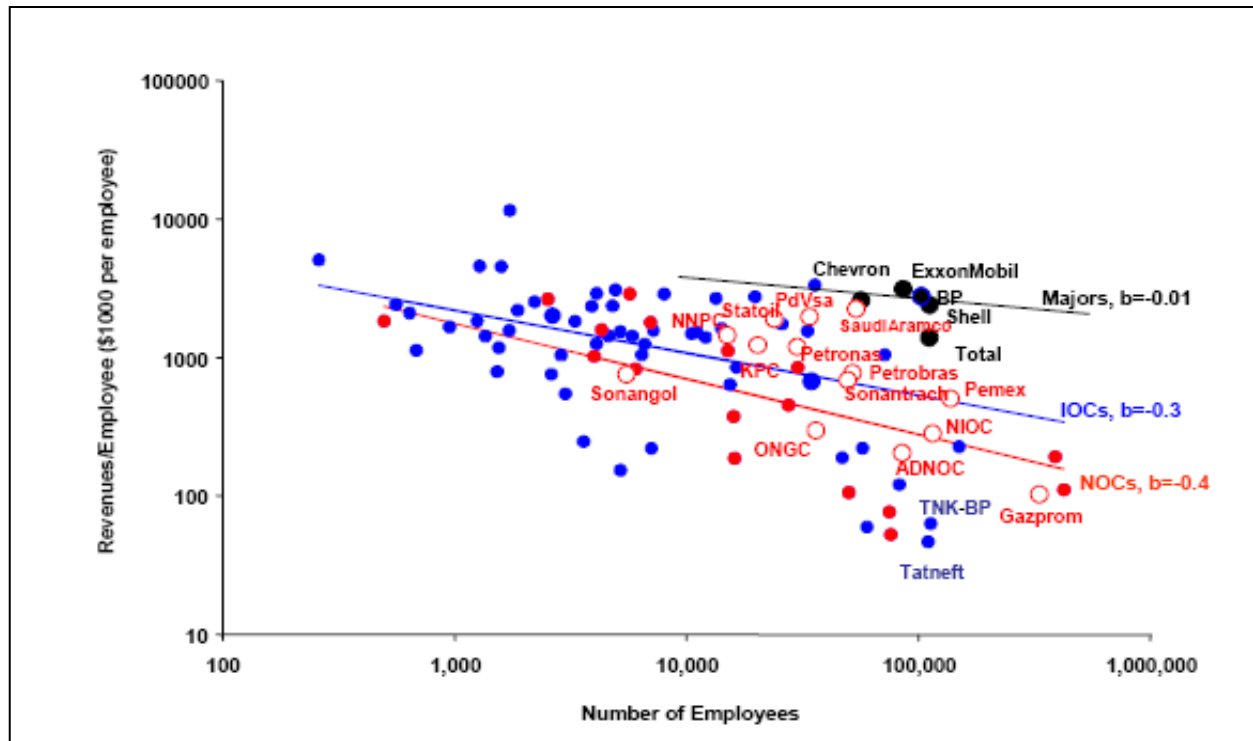
A. Inefficient project development and revenue collection

B. Quasi-fiscal roles and impact on institutional and economic development

C. Opportunity cost

D. Financial risk to taxpayers

A. Inefficient project development and revenue collection



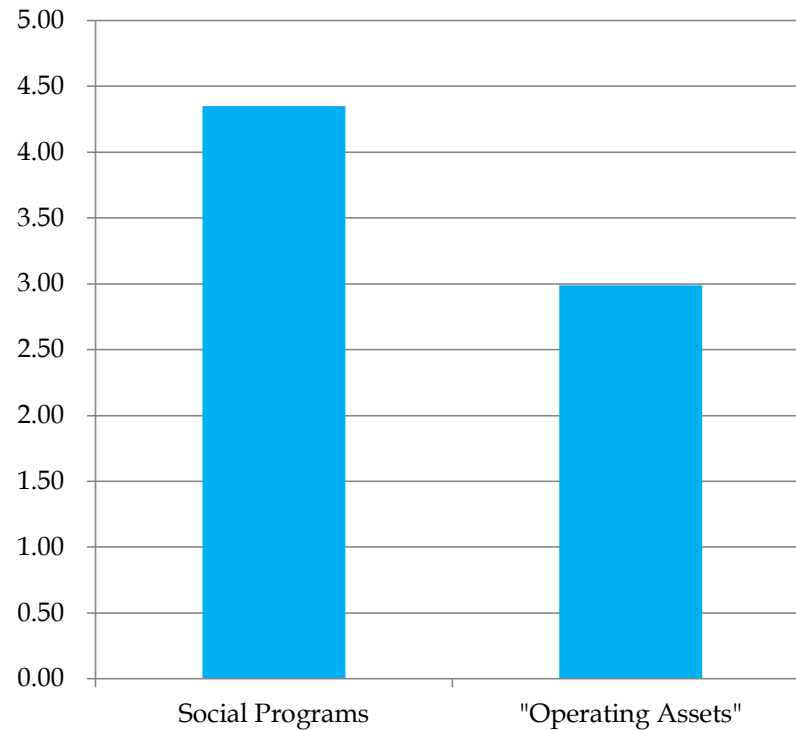
Average \$ per employee, 2004	
NOCs	\$962,000
IOCs	\$1.8 million

- NOCs
- IOCs
- Majors

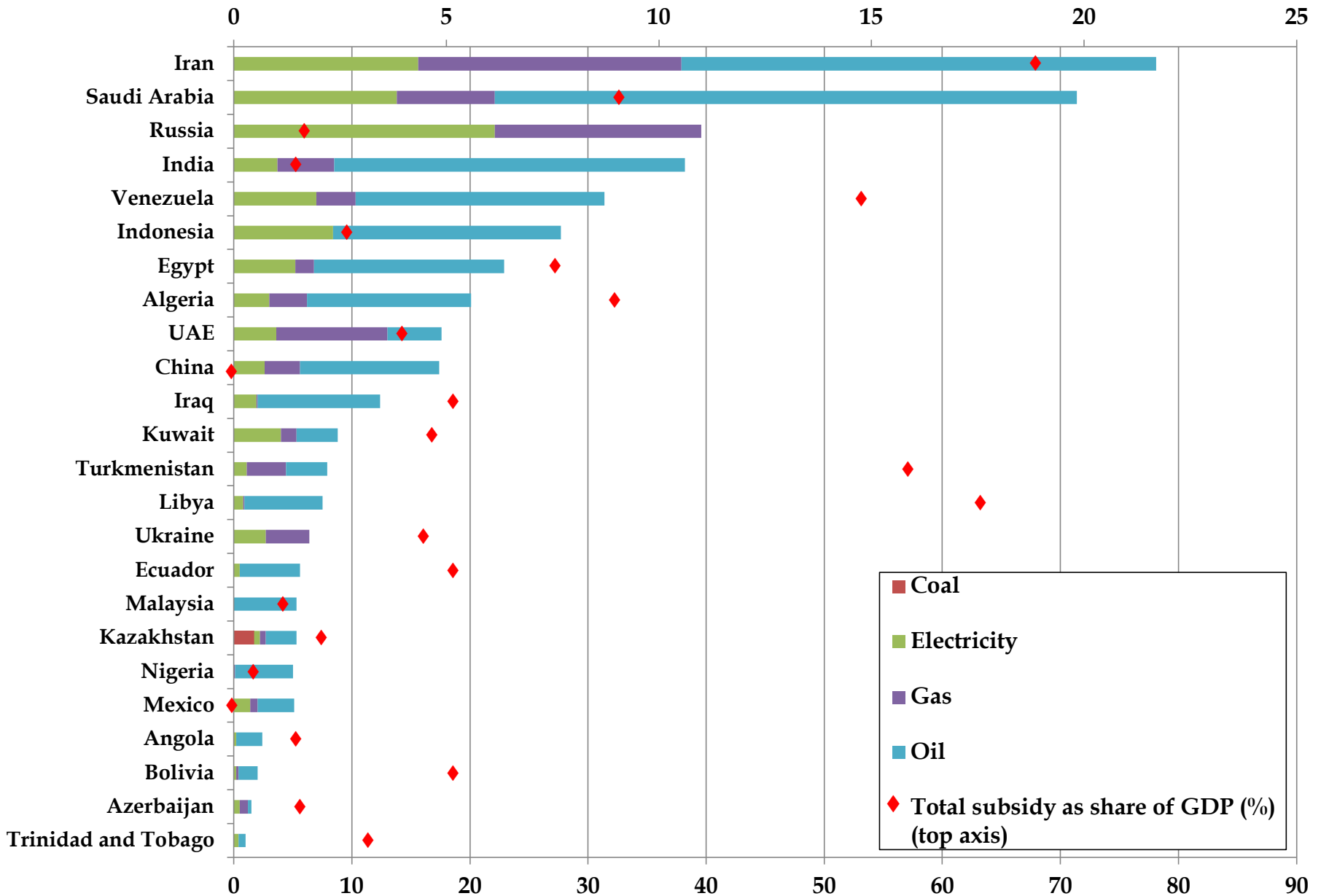
B. Quasi-fiscal role

Venezuela

PDVSA Spending, \$ billions, 2012



Cost of energy subsidies (2014)



C. Opportunity cost



Table: Distribution of Petroleum Revenues in Ghana (GHS million)

	2011	2012	2013	2014	2011-14
Total oil revenues	690.0	979.3	1,668	2,868	6,205.3
Transfer to GNPC	315.4	416.9	437.6	528.9	1,698.8
% transferred to GNPC	46%	43%	26%	18%	27%
Equity financing	274.6	224.2	134.7	127.5	761.0
Discretionary allocation by parliament	40.8	192.7	302.8	401.4	937.7

D. Financial risk to taxpayers

- Mexico
 - PEMEX's \$127 billion in unfunded pension liabilities; one third to be taken over by Mexican government
- Nigeria
 - "Cash calls" are a major drain on taxpayers (\$7 billion in 2010)
 - Petrol subsidies cost \$11 billion in 2008-09
 - Refineries lose hundreds of millions of dollars per year



Solutions: State-NOC fiscal flows

	Degree of State control	Explanation
1	High	<ul style="list-style-type: none">• All revenues will be transferred to the consolidated fund• NOC present her budget and get budget approval before receiving funding
2		<ul style="list-style-type: none">• Part of petroleum revenues that can be retained are set by law• All revenues in excess are transferred to the consolidated fund
3	Low	<ul style="list-style-type: none">• NOC operated as a 'normal' commercial entity with the state as majority (or sole) shareholder• NOC pays royalties, taxes and dividends to the state

Legislated fiscal rules can play a role in revenue retention policy

Examples:



Ghana

GNPC may retain max of 55% of carried and participating interest

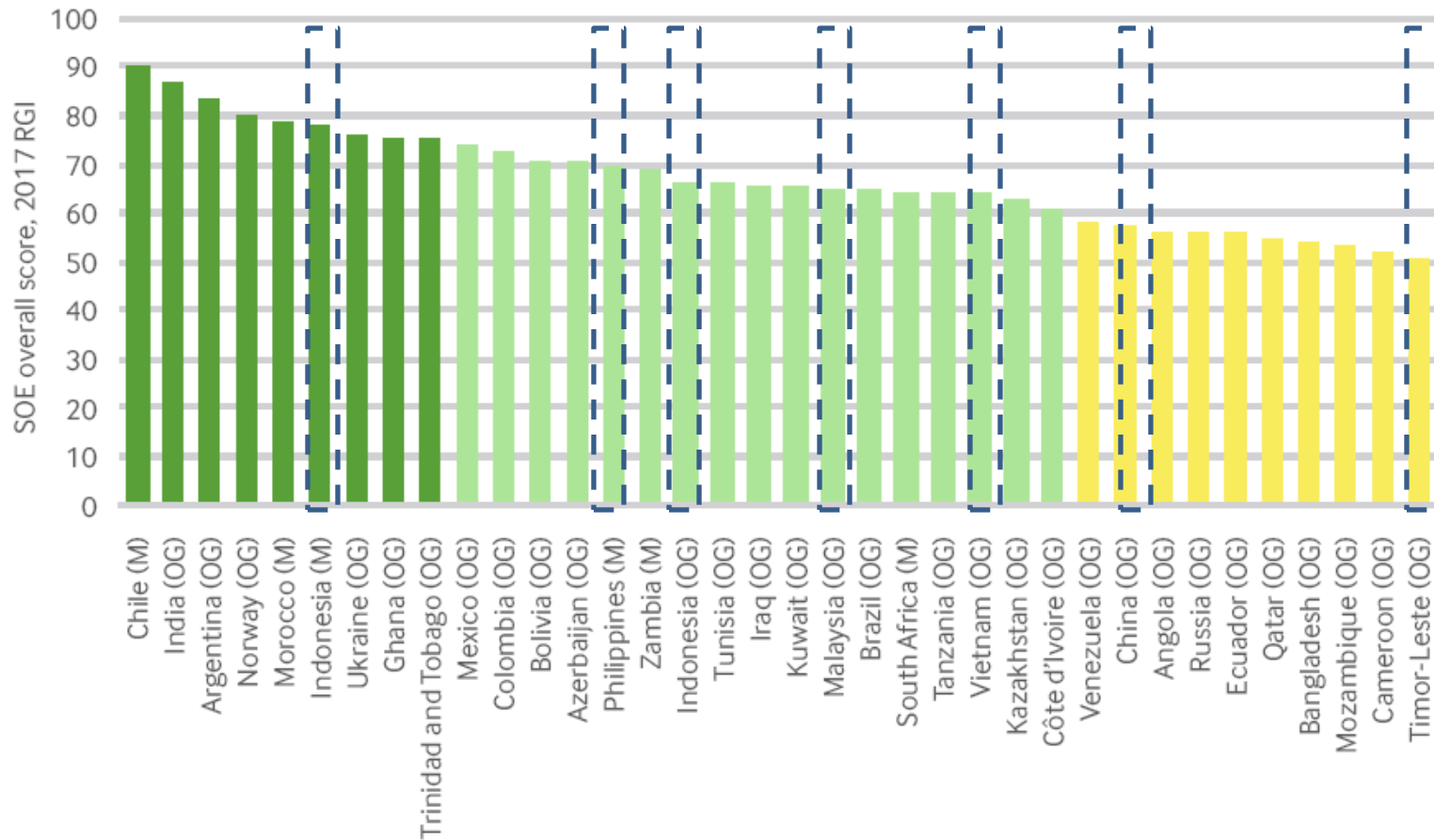


Kuwait

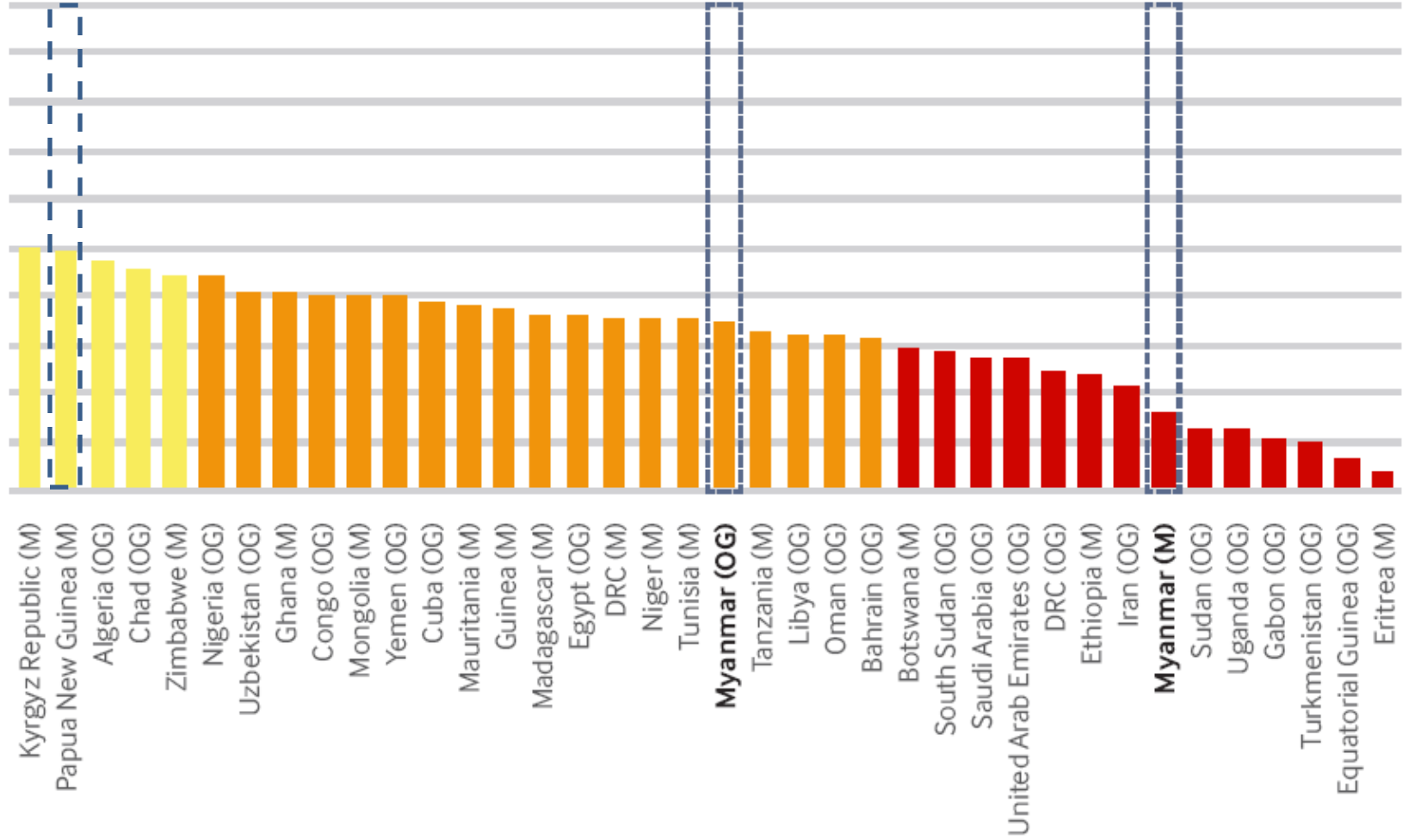
Costs, 10% for NRF, 50 cents per barrel and revenue from sales to refineries deducted from transfer to government

Regular reporting of key data and audits

Figure 21. Ranking of all state-owned natural resource companies according to 2017 Resource Governance Index score



Regular reporting of key data and audits



Ministry of Finance, SOHC or executive oversight

- Ministry of Finance can modify the budget, review plans and carry out performance evaluations
- State-owned holding company can ensure companies are meeting their objectives and centralize procurement, IT and human resources
- The executive can hire and fire managers



Parliamentary and oversight body accountability

Officials of SOEs and regulatory body can be called before parliament, supreme audit institution or other oversight body to report on activities and respond to questions



Thank You!

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